REDRESSING HARM CAUSED BY MISLEADING FRANCHISE DISCLOSURE: A ROLE FOR THE UNIFORM COMMERCIAL CODE

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Article 2 of the Uniform Commercial Code is fading in commercial and theoretical importance.[1]

U.C.C. doctrines play an important role in many franchise and distribution contracts.[2]

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[1] Raymond T. Nimmer, *An Essay on Article 2's Irrelevance to Licensing Agreements*, 40 LOY. L.A. L. REV. 235, 235 (2006).

[2] Promotional Brochure for A.B.A. Forum on Franchising, October 10-12, 2007, at 7 (2007).

I. INTRODUCTION

Some legal academics believe that Article 2[3] of the Uniform Commercial Code (UCC or Code), which governs sales of goods, is increasingly irrelevant to modern problems of commercial law.[4] Yet

[3] U.C.C. Article 2 (2002). In recent years, Article 2 of the Code has been the subject of a revision process. In 2003, the National Conference of Commissioners on Uniform State Laws promulgated a set of proposed amendments to the Article. To date, only one state legislature has enacted any of those amendments. *See* OKLA. STAT. ANN. 12A, § 2-105(1) (West Supp. 2008) (excluding "information" from the definition of "goods"); *id.*, at § 2-106(1) (West Supp. 2008) (excluding licenses of "information" from the definition of "contract of sale"); The National Conference of Commissioners on Uniform State Laws, *A Few Facts About The . . . Amendments to U.C.C. Articles 2 and 2A*, *available at* http://nccusl.org/Update/uniformact_factsheets/uniformacts-fs-ucc22A03.asp (last visited March 10, 2009). As a result, this Paper focuses on the 2002 version of Article 2, which includes amendments through 2002. The Paper focuses on the 2001 version of Article 1.

[4] Gregory Maggs writes that electronic commerce has diminished Article 2's relevance:

> [T]he recent growth of electronic commerce actually tends to diminish the importance of Article 2's present contract formation rules because it removes many sales transactions from the coverage of those rules. Moreover, although electronic commerce raises new legal issues, the states and federal government already have enacted separate legislation to deal with them.

attorneys who practice franchise law have recently devoted increased attention to the article. In 2006, for example, panelists at the American Bar Association's Annual Forum on Franchising wrote that "even in business format franchises that [UCC Articles 1 and 2 do] not govern, the commercial principles set forth in [those articles] are helpful in addressing issues with individual franchises as well as system-wide problems."[5]

As the panelists observed, Article 2 does not govern the sale of a business format franchise,[6] such as McDonald's or Burger King. The article applies only to "transactions in goods,"[7] and a franchise is not "goods" according to the Code definition.[8] The sale lies outside Article 2 even if it gives the franchisee the right to buy goods from the franchisor. The sale is then a hybrid, in which the franchisee buys not only the right to buy goods but also rights to the franchisor's intellectual property[9] and to certain services that the franchisor will perform. Most courts decide whether Article 2 applies to a hybrid sale by identifying its predominant purpose.[10] Those courts are likely to view any sale of goods, or of the right

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Gregory E. Maggs, *The Waning Importance of Revisions to U.C.C. Article 2*, 78 NOTRE DAME L. REV. 595, 598 (2003) (footnote omitted). *See also* Nimmer, *supra* note 1, at 235-37.

[5] Joseph S. Aboyoun et al., *The Impact of the Uniform Commercial Code ("U.C.C.") on Franchising*, A.B.A. 29TH ANN. F. ON FRANCHISING W16, at 40 (2006). The authors refer to the entire Code, but their paper focuses on Articles 1 and 2. *Id.* at 1. As the authors observe, Code articles other than Article 2 may apply to disputes involving business format franchises. *Id.* A security interest in the franchisee's equipment, for example, is subject to Article 9. *See, e.g.*, Daniel L. Waddell & Jim Phipps, *How Franchisors Can Benefit from U.C.C. Revised Article 9*, 21 FRANCHISE L.J. 74 (2001).

[6] *See* 1 W. MICHAEL GARNER, FRANCHISE AND DISTRIBUTION LAW AND PRACTICE § 1:14 (2007) ("Business format franchising involves, in addition to the sale of a product or service under a trademark, a marketing strategy or plan, operating manuals, standards, quality control measures and heavy supervision by the franchisor." (footnote omitted)).

[7] U.C.C. § 2-102 (2002).

[8] *See* U.C.C. § 2-105(1) (2002).

[9] The sale of the franchise will include not a sale of the intellectual property but rather a license of the right to use the property. *See, e.g.*, William A. Finkelstein & Christopher P. Bussert, *Trademark Law Fundamentals and Related Franchising Issues*, *in* FUNDAMENTALS OF FRANCHISING 1, 4 (Rupert M. Barkoff & Andrew C. Selden eds., 2004). The license poses another issue with respect to the applicability of Article 2. *See* JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE § 1-1 (5th ed. 2004); Comment, *Article 2 of the Uniform Commercial Code and Franchise Distribution Agreements*, 1969 DUKE L.J. 959, 974-77 (1969). The author of the comment submits "that the essence of a franchise agreement is the licensing of a trademark, and for reasons emanating from this premise, the granting of rights to the franchisee cannot be considered a sale within the Code since the requisite 'passing of title' to these rights does not occur. *Id.* at 977.

[10] James White and Robert Summers describe the majority and minority approaches:

> In . . . "hybrid" cases, a minority of courts apply Article 2 only to the sale of goods aspects of the transaction, whereas a majority apply Article 2 only if the "predominant purpose" of the whole transaction

to purchase goods, as a minor aspect of the sale of a business format franchise.[11] As a result, to the extent that neither a statute nor a regulation controls, the common law will govern the sale.

As the panelists also recognized, however, Article 2 principles can assist in resolving issues that arise outside the article's textual boundaries. That insight underlies a large body of case law in which courts have applied Article 2 sections by analogy to transactions other than sales of goods.[12]

In the spirit of the panelists' insight and those cases, this Paper urges courts to apply UCC section 2-313[13]—the Article 2 section on express warranties—by analogy to sales of business format franchises. In particular, courts should treat affirmations of fact and promises in a franchise disclosure document as express warranties, enforceable by the franchisee following a franchise sale. A franchisee who suffers losses caused by a false or otherwise misleading affirmation or a broken promise in a disclosure document would then have a common law contract action for breach of warranty.

Franchise disclosure documents are required by a trade regulation rule of the Federal Trade Commission (FTC or Agency). The rule, entitled "Disclosure Requirements and Prohibitions Concerning Franchising" (Rule or FTC Rule),[14] requires a franchisor to furnish a disclosure document to a prospective franchisee at least fourteen calendar days before making a binding contract with, or receiving any money from, the prospective franchisee.[15] The Agency promulgated the Rule in the exercise of its authority under the Federal Trade Commission Act (FTC Act).[16]

The Rule requires truthful disclosures, and a violation may trigger Agency enforcement,[17] but there is no private action, either express or implied, under the Rule or the FTC Act.[18] The common law warranty

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> was a sale of goods, and in that event, the majority applies Article 2 to the whole. If a sale of goods is not the "predominant purpose," then Article 2 does not apply at all.

WHITE & SUMMERS, *supra* note 9, § 1-1, at 27 (footnotes omitted).

[11] *Id.* at 9; 2 Garner, *supra* note 6, § 8:3. *See also* Stewart v. Lucero, 918 P.2d 1, 4-5 (N.M. 1996) (primary purpose of agreement for sale of business as a going concern was not sale of goods, so agreement was not subject to Article 2); Swire Pac. Holdings, Inc. *et al.* v. Dr. Pepper/Seven-Up Corp., No. 05-95-01525-CV, 1997 WL 153794, at *5 (Tex. App. Apr. 3, 1997) (license of right to use soft-drink syrups in making soft drinks and other non-sale aspects of franchise agreement predominated, so agreement was not subject to Article 2).

[12] *See infra* notes 262-63 and accompanying text.

[13] U.C.C. § 2-313 (2002).

[14] 16 C.F.R. §§ 436.1 to .11 (2008).

[15] *Id.* § 436.2.

[16] 15 U.S.C. §§ 41-58 (2006). For the Agency's authority to promulgate the Rule, see *id.* § 57a(a).

[17] *Id.* § 57b (2006).

[18] *See infra* notes 67-82 and accompanying text.

action would help remedy the injustice that the lack of a private action can create.

Part II of this Paper explains the problem that can result from the lack of a private action. The Part begins with a hypothetical case which illustrates the harm that a Rule violation can produce and then reviews tort and contract actions, other than warranty actions, that might in theory be available to the injured franchisee. The review reveals an uneven legal landscape. Depending on the jurisdiction, the injured franchisee may or may not be able to hold the franchisor liable under the common law of torts or a state statute. Absent a warranty, moreover, the franchisor may not be liable for breach of contract.

Part III explains and endorses the express warranty action that the franchisee can invoke as at least a partial solution to the problem. Although the common law governs the franchise sale, in every state except Louisiana[19] UCC section 2-313 can play an important role in persuading the court that the contents of the disclosure document should be enforceable as express warranties. Even if the court adopts the warranty action, however, the common law of contract may leave the injured franchisee one step short of recovery. Evidence of an express warranty that is not incorporated in a formal contract of sale may be excluded under the parol evidence rule. Part II therefore concludes with an analysis of a new FTC Rule provision that the franchisee can invoke to ensure that the court will admit the evidence of the warranty.

II. THE PROBLEM

A. Misleading Disclosure and Resulting Injury

Consider the hypothetical case of Louisa Brown,[20] who lived in a major city and wanted to operate her own business. In response to an advertisement for Paula's Ice Cream Parlor (Paula's) franchises Brown met with a sales manager for the company. The manager gave her a franchise disclosure document that contained the following provision:

> Paula's employs its own real estate location experts to assist its franchisees in succeeding in their stores. Paula's will assume responsibility for selecting, obtaining, and negotiating a suitable location for the Paula's store. When a location has been approved, Paula's will negotiate a

[19] Louisiana has not adopted Article 2 of the Code. *See* WHITE & SUMMERS, *supra* note 9, at 1.

[20] Brown's story is based loosely on the facts of *Brennan v. Carvel Corp.*, 929 F.2d 801 (1st Cir. 1991).

> rental arrangement, prepare and approve lease documents, and handle the closing and signing of the lease.[21]

The document stated that Paula's made no earnings claim to prospective franchisees, and that no representative of the company had authority to make any such claim. It did not state that the affirmations and promises it contained would survive the closing of a franchise sale.

A Paula's employee named Alan Swift, who had recently been given responsibility for site selection, worked with Brown in finding a location for her store.[22] Swift lacked experience in locating soft ice cream franchise stores in downtown areas. He conducted a survey, but the survey contained inaccuracies concerning the location of streets and landmarks and relied on some obsolete information. Based on the survey results and his limited experience, he approved a site in a downtown location.

Most soft ice cream stores in the greater metropolitan area were located in suburban locations, and seventy per cent of the sales of a typical Paula's store were take-home sales. A downtown store was not well suited to take-home sales because customers had to worry about the ice cream melting on the way home. Moreover, there was insufficient foot traffic to sustain a soft ice cream store at the site.

Brown believed that Swift was an expert, and she relied on his approval of the site. She and Paula's signed a document (Franchise Agreement), thereby making a contract (Franchise Contract) for the sale of a franchise.[23] The Franchise Contract gave her the right to operate a

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[21] In *Brennan*, the disclosure document which Carvel gave to prospective franchisees in Boston contained the following provision:

> Carvel will assume responsibility for selecting, obtaining and negotiating a suitable location for the Carvel Store. When a location has been approved, Carvel will negotiate a rental arrangement, prepare and approve lease documents, and handle the closing and signing of the lease. A one time real estate fee of $2,500.00 is paid by the [franchisee].

Id. at 804. An informational brochure given to the franchisees with the disclosure document stated: "Carvel employs its own Real Estate location experts . . . dedicated to help its [franchisees] succeed in their stores." *Id.* at 803.

[22] Selection of sites for franchises can occur either before or after execution of a franchise agreement. Gaylen L. Knack & Troy A. Bader, *Franchisor Liability in the Market-Development and Site-Selection Process: Location, Location . . . Liability?*, 13 FRANCHISE L.J. 39, 42 (1993) ("In certain instances, the site may be selected in advance of the execution of a franchise or site-selection agreement. Franchisors may also locate a site for a prospective franchised business pursuant to the terms of a franchise or a site-selection agreement.").

[23] Arthur Corbin lists three different meanings of the term "contract":

Paula's store at the site. The Franchise Agreement made no reference to site selection or site selection assistance, and it contained a merger, or integration, clause.

Brown worked diligently in her store but soon discovered that the site was not suitable for a soft ice cream franchise. She did her best to obtain accounts for "office and institutional" sales, and managed to obtain about thirty such accounts, but in the end she was forced to close the store. Her losses included both her sunk costs and the profits she had expected to make.

B. Possible Tort and Non-Warranty Contract Actions

Brown may sue in tort and/or for breach of contract without invoking warranty law. This subpart assesses her prospects for success, first in tort and then in contract.

1. Tort

Brown may consider one or more of five tort actions: violation of the FTC Rule, negligence *per se*, violation of a state franchise disclosure act, violation of a state unfair trade practices act, and common law misrepresentation.[24] The first action will almost certainly fail. Depending

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> A study of its common usage will show that the term "contract" has been made to denote three different kinds of things in various combinations: (1) the series of operative acts of the parties expressing their assent, or some part of these acts; (2) a physical document executed by the parties as an operative fact in itself and as lasting evidence of their having performed other necessary acts expressing their intention; (3) the legal relations resulting from the operative acts of the parties, always including the relation of right in one party and duty in the other.

1 ARTHUR L. CORBIN, CORBIN ON CONTRACTS § 3 (1963). In this Paper, "Franchise Agreement" refers to the document that Brown and Paula's executed to conclude the sale of her franchise and "Franchise Contract" refers to the legal relations resulting from their operative acts. The term "franchise agreement" refers to a document executed to conclude the sale of a franchise by a franchisor other than Paula's to a franchisee other than Brown. The term "franchise contract" refers to the legal relations resulting from the execution of a franchise agreement by parties other than Brown and Paula's.

[24] *See generally* John D. Holland et al., *Litigating Disclosure Claims*, A.B.A. 31st ANN. F. ON FRANCHISING W 20 (2008). A sixth tort possibility in Brown's case may lie in the law of negligence. In *J & R Ice Cream Corp. v. California Smoothie Licensing Corp.*, 31 F.3d 1259 (3rd Cir. 1994), a prospective franchisee named J & R Ice Cream entered into a site selection agreement with a franchisor called California Smoothie Licensing. The agreement made site selection and lease negotiation J & R's responsibility, but California Smoothie actually selected a site and negotiated a lease for J & R's store. J & R paid a franchise fee and executed a franchise agreement, but experienced disappointing sales and paid a higher percentage of gross sales in maintenance fees than its principals had expected to pay. *Id.* at 1262-64. J & R sued, and a jury rendered a verdict in its favor on

on the governing jurisdiction (Brown's jurisdiction or her jurisdiction), one or more of the other four may succeed. This section begins by assessing the viability of each of the five and then concludes with a general observation concerning the likelihood of a tort recovery.

a. The Five Actions

i. The FTC Rule

The disclosure document that Paula's gave Brown stated that the company employed site selection experts, and it promised that Brown would receive expert assistance. Swift was not an expert, however, and he provided inept assistance. The document was misleading,[25] and by furnishing it to her, the company violated the Rule.[26] Moreover, the

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the negligence count in its complaint. *Id.* at 1264-65. The Third Circuit concluded that the site selection agreement did not require California Smoothie to select a site or negotiate a lease for J & R and that the relationship between the parties was "essentially contractual." *Id.* at 1275. Courts are often reluctant to hold parties liable in tort for careless performance of their contractual obligations. *See, e.g.*, Princess Cruises v. Gen. Elec., 950 F. Supp. 151, 155 (E.D. Va. 1996), *rev'd on other grounds*, 143 F.3d 828 (4th Cir. 1998) ("Almost any contract breach can be conceived of in terms of a negligent . . . tort claim. . . . But to permit a party to a broken contract to proceed in tort where only economic losses are alleged would eviscerate the most cherished virtue of contract law, the power of the parties to allocate the risks of their own transactions."); Clark-Fitzpatrick v. Long Island R.R., 516 N.E.2d 190, 193-94 (N.Y. 1987); 2 DAN B. DOBBS, THE LAW OF TORTS § 452 (Practitioner ed. 2001) ("[W]here commercial loss is suffered by parties to a transaction, contract law is adequate to deal with the problem and also usually more appropriate." (footnote omitted)). In *J & R*, the Third Circuit wrote that a party to a contract can be liable in negligence if "the act complained of [is] the direct result of duties voluntarily assumed . . . in addition to the mere contract." *J & R*, 31 F.3d at 1275 (quoting Walker Rogge, Inc. v. Chelsea Title & Guar. Co., 562 A.2d 208, 221 (N.J. 1989)). California Smoothie had assumed a greater duty, and the jury's verdict for J & R on the negligence count could stand. *Id.* The court did not specify which acts of California Smoothie fell below the standard of ordinary care, so the case is not clearly on all fours with Brown's. Yet she can argue that, by affirming its personnel's expertise and promising expert assistance, Paula's assumed an obligation to provide expert site selection assistance. Swift's lack of credentials and his sloppy work may have manifested a lack of ordinary care on Paula's part, so there may be some prospect of a negligence recovery. For a case in which the court dismissed a claim for negligence in site selection because the parties had entered into a contract, see *Banek v. Yogurt Ventures, Inc.*, 1992 U.S. Dist. LEXIS 21453, at *17-18 (E.D. Mich. Oct. 15, 1992). A negligence claim in Brown's case would be based on Swift's site selection work, and not on the misleading disclosure Brown received. A claim that the disclosure, as opposed to the site selection, was negligent would fall under the heading of negligent misrepresentation. *See infra* notes 139-44 and accompanying text.

[25] If Swift was the only "bad apple" among Paula's many site selection personnel, a fact finder might not consider the company's affirmation of site selection expertise to have been false. Except where otherwise indicated, however, this Paper is based on the assumption that a sufficient number of those personnel lacked expertise that a fact finder would conclude that the affirmation was false.

[26] The assumption, of course, is that the sale of the franchise did not fall within one of the Rule's exemptions. *See* 16 C.F.R. § 436.8 (2008).

violation led directly to her losses. Her enforcement options, however, are extremely limited.

(A) Paula's Violation of the Rule

The Rule requires disclosure of twenty-three "items," each consisting of information concerning the franchisor or an aspect of the working relationship the parties will have.[27] Item 11, entitled "Franchisor's Assistance, Advertising, Computer Systems, and Training," instructs franchisors in relevant part as follows:

> Disclose the franchisor's principal assistance and related obligations of both the franchisor and franchisee as follows. For each obligation, cite the section number of the franchise agreement imposing the obligation. Begin by stating the following sentence in bold type: "EXCEPT AS LISTED BELOW, [THE FRANCHISOR] IS NOT REQUIRED TO PROVIDE YOU WITH ANY ASSISTANCE."
>
> (1) Disclose the franchisor's pre-opening obligations to the franchisee, including any assistance in:
>
> (i) Locating a site and negotiating the purchase or lease of the site. If such assistance is provided, state:
>
> . . .
>
> (B) Whether the franchisor selects the site or approves an area in which the franchisee selects a site. If so, state further whether and how the franchisor must approve a franchisee-selected site.[28]

Brown will argue that those provisions obligated Paula's to disclose the assistance she would receive concerning site selection. In the Rule, the word "disclose" means "to present all material facts accurately, clearly, concisely, and in plain English."[29] The disclosure document's inaccurate affirmation concerning site selection expertise constituted a failure to disclose the assistance the company provided, and that failure violated the Rule.

Paula's will respond with a narrow interpretation of Item 11. Subsection (1)(i), on which Brown relies, requires disclosure of site selection assistance only if the assistance is an obligation of the franchisor. The language preceding subsection (1) makes clear that franchisor obligations are created by the franchise agreement: "For each obligation,

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[27] *See id.* § 436.2, *id.* § 436.5.
[28] *Id.* § 436.5(k).
[29] *Id.* § 436.1(d).

cite the section number of the franchise agreement imposing the obligation."[30] Paula's disclosure document described assistance to be furnished at a time when the company and Brown had not yet executed their Franchise Agreement. As a result, the assistance was not an obligation of the company. The company was therefore not required to disclose the assistance, and its inaccurate affirmation was not a violation.[31]

Brown can offer at least three responses. First, the FTC's Statement of Basis and Purpose suggests that the narrow interpretation is inappropriate. The Agency refers to the comments of a franchisee named Lundquist, whose case resembles Brown's. Lundquist's comments appear to have played an important role in prompting the drafting of the site selection provisions.[32] Lundquist reported that her franchise failed at least in part because her franchisor did not follow its own criteria in selecting the site for her store, which was in an urban location. She also stated that most of the franchisor's stores were in suburban locations, and that the franchisor lacked experience in siting stores in urban areas. Her testimony did not reveal whether site selection in her case occurred before or after she signed her franchise agreement. Moreover, none of the questions asked by the FTC officials conducting the hearing indicated any interest in the timing of the assistance.[33] The Agency's reliance on her report thus appears to reflect a belief in the need for accurate disclosure of site selection assistance

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[30] *See supra* text accompanying note 28.

[31] Paula's can add that subsection 436.5(k)(2) also supports its narrow interpretation. That subsection provides as follows:

> Disclose the typical length of time between the earlier of the signing of the franchise agreement or the first payment of consideration for the franchise and the opening of the franchisee's business. Describe the factors that may affect the time period, such as ability to obtain a lease, financing or building permits, zoning and local ordinances, weather conditions, shortages, or delayed installation of equipment, fixtures, and signs.

16 C.F.R. § 436.5(k)(2) (2008). That language recognizes the possibility of the following sequence: (1) payment of the first consideration, (2) obtaining a lease, and (3) execution of a franchise agreement. In that sequence, any franchisor assistance in selecting a site would necessarily occur before execution of a lease, and thus before the parties have executed a franchise agreement. Paula's can argue that the agency, having recognized that possibility, must have made a conscious choice to draft the portion of Item 11 quoted in the text so as to require disclosure of site selection assistance only if the franchisor will render the assistance after the parties have executed a franchise agreement. The limitation could not have been inadvertent.

[32] *See* Federal Trade Commission, Disclosure Requirements and Prohibitions Concerning Franchising, Statement of Basis and Purpose, 72 Fed. Reg. 15,445, at 15,489 n.477 (March 30, 2007) [hereinafter 2007 Statement of Basis and Purpose].

[33] *See* Federal Trade Commission Workshop Concerning Proposed Revision of Franchise Rule, Lundquist, ANPR, 22 Aug. 97 Tr. at 42-51, http://www.ftc.gov/bcp/franchise/xscripts/822bus.pdf.

regardless of when the assistance occurs in relation to the execution of a franchise agreement.

Second, there is no good policy reason for applying Item 11 only to assistance furnished after the execution of a franchise agreement. The harm to Brown is every bit as severe as if she had first signed her Franchise Agreement and then relied on Paula's false affirmation. As the FTC's Statement of Basis and Purpose makes clear, prospective franchisees need to be able to rely on all items of information provided in a disclosure document: "The [FTC] has long recognized that the integrity of a franchisor's disclosures is critical to prospective franchisees who rely on such information in making their investment decision. For that reason, disclosure documents must be complete, accurate, legible, and current."[34] The court should reject Paula's interpretation as unduly narrow and at odds with the Rule's fundamental purpose.

Third, if the site selection assistance was not an obligation of Paula's and therefore not required to be disclosed, then the company has violated a different subsection of the Rule. Subsection 436.6(d) provides in part: "Do not include any materials or information other than those required or permitted by [the Rule] or by state law not preempted by [the Rule]."[35] Under both the Rule[36] and state disclosure laws,[37] disclosure documents must consist of accurate information; franchisors are not permitted to include false or misleading information concerning pre-agreement site selection assistance.

(B) Enforcement

In theory, a franchisee in Brown's position could seek redress under the FTC Rule in either or both of two ways. First, she could file a complaint with the FTC, hoping that the Agency would act against Paula's and she would receive some compensation as a result. Second, she could sue the company for violating the Rule. If she complains to the Agency, there is some chance of a recovery. If she sues the company for violating the Rule, however, she will almost certainly lose.

By violating the Rule, Paula's committed an unfair trade practice under the FTC Act,[38] which authorizes Agency civil actions against

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[34] 2007 Statement of Basis and Purpose, *supra* note 32, at 15,534.
[35] 16 C.F.R. § 436.6(d) (2008).
[36] *Id.* § 436.1(d).
[37] *See, e.g.*, North American Securities Administrators Association, Inc. (NASAA) 2008 Franchise Registration and Disclosure Guidelines (Amended and Restated UFOC Guidelines), http://www.nasaa.org/content/Files/2008UFOC.pdf. The Uniform Franchise Registration Application included in the Guidelines requires the franchisor to certify that "all material facts stated in the franchise disclosure document are accurate . . . ." *Id.* at 9.
[38] The Rule provides in part:

> In connection with the offer or sale of a franchise to be located in the United States of America or its territories . . . it is an unfair or

violators.[39] In such an action, the court can award compensation to a party injured by the practice.[40]

For any of a variety of reasons, however, the FTC may decide not to proceed. The Act requires that an enforcement proceeding be in the public interest,[41] and the Agency may decide that the public interest does not justify action in Brown's case. Resource constraints create a

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> deceptive act or practice in violation of Section 5 of the Federal Trade Commission Act:
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> (a) For any franchisor to fail to furnish a prospective franchisee with a copy of the franchisor's current disclosure document, as described in Subparts C and D of [the Rule], at least 14 calendar-days before the prospective franchisee signs a binding agreement with, or makes any payment to, the franchisor or an affiliate in connection with the proposed franchise sale.

16 C.F.R. § 436.2 (2008). The twenty-three disclosure items, including Item 11, are listed in Subpart C, *infra*. *See id.*, at § 436.5(k). In addition, section 436.6(a) provides in part: "It is an unfair or deceptive act or practice in violation of Section 5 of the FTC Act for any franchisor to fail to include the information and follow the instructions for preparing disclosure documents set forth in Subpart C . . . of part 436." *Id.*, at § 436.6(a).

The FTC Act provides in part: "If any person, partnership, or corporation violates any rule under [the FTC Act] respecting unfair or deceptive acts or practices . . . then the [FTC] may commence a civil action against such person, partnership, or corporation for relief under subsection (b) of this section in a United States district court or in any court of competent jurisdiction of a State." 15 U.S.C. § 57b(a)(1) (2006).

[39] *See* 15 U.S.C. § 57b(b)(a)(1) (2006).

[40] Subsection 57b(b) of the FTC Act provides:

> The court in an action under subsection (a) of this section shall have jurisdiction to grant such relief as the court finds necessary to redress injury to consumers or other persons, partnerships, and corporations resulting from the rule violation . . . . Such relief may include, but shall not be limited to, rescission or reformation of contracts, the refund of money or return of property, the payment of damages, and public notification respecting the rule violation . . . except that nothing in this subsection is intended to authorize the imposition of any exemplary or punitive damages.

15 U.S.C. § 57b(b) (2006). *See also* 1 GARNER, *supra* note 6, § 5A:19, at 5A-31 ("The FTC may . . . obtain consumer redress; in so doing, it is not necessary to show that every consumer actually relied upon the misrepresentations, but only that the defendant made misrepresentations which were the type that a reasonable and prudent person would rely on." (footnote omitted)); David J. Meretta & Eric H. Karp, *Regulation FD: Roadmap to Better Relations Between Franchisors and Franchisees*, 26 FRANCHISE L.J. 117, 119 (2007).

[41] 15 U.S.C. § 45(b) (2006). If the Agency does decide to proceed, a reviewing court will probably not find that it has exceeded the public-interest limitation. Jeff Sovern, *Private Actions Under the Deceptive Trade Practices Acts: Reconsidering the FTC Act as Rule Model*, 52 OHIO ST. L.J. 437, 442 (1991).

disincentive for enforcement actions except in cases involving many injured parties and severe harms.[42] Particularly if Paula's is a small franchise system, the number of injured franchisees may be small. The aggregate losses may not appear great even though Brown and some other franchisees may have lost much of their net worth. Moreover, the company may not have reaped a significant profit. Despite the harm to Brown and perhaps also to other franchisees in the Paula's system, then, the Agency may well conclude that the benefits of an enforcement proceeding would not justify the costs that the proceeding would entail.[43] If Brown then sues to compel the Agency to act, she will almost certainly lose.[44]

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[42] *See* Sovern, *supra* note 41, at 448. In 1984, the FTC published a Franchise Rule Enforcement Protocol which suggested that Agency enforcement was more likely to occur in cases in which the violation(s) had injured numerous franchisees and greatly enriched the franchisor. FTC Franchise Rule Enforcement Protocol, 16 C.F.R. § 14.17 (c)(1) to (4) (1994) *repealed by* Federal Trade Commission, Administrative Interpretations, General Policy Statements, and Enforcement Policy Statements, 60 Fed. Reg. 42,031, 42,031 (1995). In 1995, however, the Agency rescinded the protocol, along with other interpretations, guidelines, and policy statements that [were] unnecessary, superfluous or obsolete . . . ." Federal Trade Commission, Administrative Interpretations, General Policy Statements, and Enforcement Policy Statements, 60 Fed. Reg. 42,031, 42,031 (1995). The Agency's explanation of the rescission does not make clear whether the emphasis on large numbers of franchisees and large amounts of money had changed:

> The [FTC] . . . has investigated and filed in court the vast bulk of its Franchise Rule enforcement actions since it published [the rescinded] enforcement protocol in 1984. Thus, the protocol does not reflect, fully and accurately, the [FTC's] present enforcement policy. Moreover, the [FTC] currently is reviewing the Franchise Rule under its ongoing regulatory review program.
>
> . . . The Commission will consider whether it is necessary to issue an updated version of the protocol to reflect current law, fact and policy after it completes its regulatory review of the Franchise Rule.

Id. at 42,033 (footnote omitted). Although the agency has promulgated an updated rule, it has not issued a new enforcement protocol. The United States General Accounting Office interviewed FTC enforcement personnel and reported:

> FTC staff told us that limited resources and other law enforcement priorities prevented FTC from pursuing every meritorious complaint and investigation involving franchises and business opportunities. They said that FTC generally pursued those cases it believed would have the greatest likelihood of financial recovery for franchise and business opportunity purchasers or the greatest deterrent effect for potential violators.

U.S. GENERAL ACCOUNTING OFFICE, FEDERAL TRADE COMMISSION ENFORCEMENT OF THE FRANCHISE RULE 2, GAO 01-776 (July 31, 2001).

[43] An experienced franchise practitioner reports:

Brown might also sue Paula's for violating the FTC Rule. Neither the Rule[45] nor the FTC Act[46] expressly authorizes suits by injured parties against violators. For at least five reasons, however, Brown can urge the court to imply a private action. First, she can invoke the bedrock notion that where there is a wrong there must be a remedy;[47] Paula's wrongful conduct injured her and she ought to receive compensation. If, for perfectly rational and honorable reasons, the FTC decides not to proceed against

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> Like so many other governmental agencies, [the FTC] has been given a gigantic mission, but limited resources to carry out its mandate. Thus, triage has been the necessary strategy followed by the FTC in the area of franchise sales regulation enforcement. It looks for situations where the fraud is blatant and where there is widespread injury to the public. The individual franchisee who has been injured typically is left on his own to pursue justice.

Rupert M. Barkoff, *Franchise Sales Regulation Reform: Taking the Noose Off the Golden Goose*, 3 ENTREPRENEURIAL BUS. L.J. 233, 246 (2009). *See also* M. Thomas Arnold, *Taking Note of the Investment Aspects of Purchasing a Franchise: A Proposal for Required Electronic Filing of Pre-sale Disclosure Documents*, 3 ENTREPRENEURIAL BUS. L.J. 209, 213 (2009) (characterizing FTC enforcement as "not very vigorous").

[44] *See* Heckler v. Chaney, 470 U.S. 821 (1984). In *Heckler*, the Supreme Court concluded that an administrative agency's decision not to bring an enforcement action "is a decision generally committed to [the] agency's absolute discretion." *Id.* at 831. Title 5, section 702 of the United States Code provides for judicial review of administrative agency action. 5 U.S.C. § 702 (2006). Under section 701(a)(2), however, courts cannot review agency decisions that are "committed to agency discretion by law." 5 U.S.C. § 701(a)(2) (2006). The Court concluded that "agency decisions not to undertake enforcement actions should be presumed immune from judicial review under § 701(a)." *Heckler*, *supra*, at 832. The presumption of immunity may be rebutted, the Court wrote, if the substantive statute under which the agency acts "has provided guidelines for the agency to follow in exercising its enforcement powers." *Id.* at 832-33. The question in Brown's case, therefore, is whether the FTC Act provides guidelines for the FTC to follow in deciding whether to bring enforcement actions. The answer appears to be that the FTC Act does not do so. *See* Sovern, *supra* note 41, at 441 n.21 ("Not only can consumers not sue under the FTC Act, but also consumers also have no recourse when the [FTC] declines to bring a case."). *See also* Arthur Best, *Controlling False Advertising: A Comparative Study of Public Regulation, Industry Self-Policing, and Private Litigation*, 20 GA. L. REV. 1, 16 (1985) ("The [FTC] has almost total independence in deciding to commence cases. Consumers and competitors may request that the FTC begin investigations or prosecutions, but an FTC decision to reject these suggestions is not reviewable." (footnotes omitted)). For general discussion of judicial review of agency inaction, see ALFRED C. AMAN, JR. & WILLIAM T. MAYTON, ADMINISTRATIVE LAW § 13.11 (2d ed. 2001).

[45] *See* 16 C.F.R. §§ 436.1 to .11 (2008).

[46] *See* 15 U.S.C. §§ 41-58 (2006).

[47] *See, e.g.*, Susan J. Stabile, *The Role of Congressional Intent in Determining the Existence of Implied Private Rights of Action*, 71 NOTRE DAME L. REV. 861, 864 (1996) (In the early 1800s, courts endorsed that notion: "Since there was a remedy for all wrongs, if Congress did not provide for that remedy, the courts should and did.").

Paula's and Brown has no cause of action under the Rule, she may be left with no remedy, and the result will be an injustice.[48]

Second, Congress may well have passed the FTC Act in the expectation that courts would imply private actions to supplement Agency enforcement. The FTC Act became effective in 1914, at a time when at least some American courts were generally willing to imply private actions.[49] Congress, which must have been aware of that practice, failed to include any language forbidding implication.[50] Brown's argument is more forceful than it would have been if the climate in 1914 had been inhospitable to implication.

Third, courts have recognized implied private actions under other, arguably analogous federal laws,[51] including Rule 10b-5,[52] promulgated by the Securities and Exchange Commission pursuant to section 10(b) of the Securities Exchange Act of 1934.[53] Just as section 10(b) and Rule 10b-5 are designed to combat deception in the sale of securities, the FTC Rule is designed to combat deception in the sale of franchises.[54]

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[48] *See* Donald H. Zeigler, *Rights Require Remedies: A New Approach to the Enforcement of Rights in the Federal Courts*, 38 HASTINGS L. J. 665, 677-81 (1987) (explaining why legal rights require remedies).

[49] *See id.*, at 675-77; H. Miles Foy III, *Some Reflections on Legislation, Adjudication, and Implied Private Actions in the State and Federal Courts*, 71 CORNELL L. REV. 501, 546 (1986). *See also* Margaret V. Sachs, *Exclusive Federal Jurisdiction for Implied Rule 10b-5 Actions: The Emperor Has No Clothes*, 49 OHIO ST. L.J. 559, 572 (1988) (By 1934, implication of private actions "had been largely confined to state statutes and local ordinances.").

[50] *See* 15 U.S.C. §§ 41-58 (2006).

[51] *See* J.I. Case Co. v. Borak, 377 U.S. 426 (1964) (finding a private action under section 14(a) of the Securities Exchange Act, 15 U.S.C. § 78n(a) (2006), and Rule 14a-9, 17 C.F.R. § 240.14a-9 (2008)); H.K. Porter Co. v. Nicholson File Co., 482 F.2d 421, 423-24 (1st Cir. 1973) (implied private action under § 14(e) of the Securities Exchange Act, 15 U.S.C. § 78n(e) (2006)); Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran, 456 U.S. 353, 374-88 (1982) (implied private action under several sections of the Commodity Exchange Act, 7 U.S.C. §§ 1 to 27f (2006)).

[52] 17 C.F.R. § 240.10b-5 (2007).

[53] 15 U.S.C. §§ 78a - nn (2006). *See* Superintendent of Ins. of N.Y. v. Bankers Life & Cas. Co., 404 U.S. 6, 13 n.9 (1971) ("It is now established that a private right of action is implied under § 10b").

[54] Indeed, prospective franchisees are arguably in greater need of protection than buyers of securities:

> [T]he franchisee often will be required to make a huge investment in the franchised business. Even when the investment made is not so large, it may represent most of the purchasers' net worth. A purchaser of common shares often invests a smaller percentage of his or her wealth in any particular company and, as a result, gains a certain amount of protection against loss by virtue of his or her ability to acquire a diversified portfolio. In addition, a purchaser of common shares in a public company generally has an exit; he or she can easily sell the shares. A franchisee cannot so easily exit the

Fourth, in its Statement of Basis and Purpose, the FTC has explicitly endorsed implied private actions under the Rule:

> The [FTC] believes that the courts should and will hold that any person injured by a violation of this rule has a right of action against the violator, under the Federal Trade Commission Act, as amended, 15 U.S.C. §§ 41-58 (1976), and this rule. The existence of such a right is necessary to protect the members of the class for whose benefit the statute was enacted and the rule is being promulgated, is consistent with the legislative intent of the Congress in enacting the Federal Trade Commission Act, as amended, and is necessary to the enforcement scheme established by the Congress in that Act and to the [FTC's] own enforcement efforts.[55]

Although the Agency's position has been public knowledge since 1979, moreover, Congress has not acted to prohibit the implication of a private action under the Rule.

Fifth, private enforcement of the Rule is appropriate even if private enforcement of section five of the FTC Act is inappropriate. Section five provides, in relevant part, that "[u]nfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce, are hereby declared unlawful."[56] That highly general phrasing arguably militates against recognition of a private action to enforce the section in the absence of a more detailed rule.[57] A private action could create a risk of litigation that is both vexatious to franchisors and not in the

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> franchise system. Thus, it may be more critical for the purchaser of a franchise to make an informed investment decision than the purchaser of common shares.

Arnold, *supra* note 43, at 230-31 (footnotes omitted).

[55] The quoted language appears in the Statement of Basis and Purpose that accompanied the original Federal Trade Commission Franchise Rule, which the Agency promulgated in 1978. *See* Federal Trade Commission, Statement of Basis and Purpose Relating to Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures, 43 Fed. Reg. 59,621, at 59,723 (Dec. 21, 1978). The 2007 Statement of Basis and Purpose, issued with the revised Rule, does not address private actions, but it does provide that the original statement "remains valid, except to the extent of any conflict with the final amended Rule." 2007 Statement of Basis and Purpose, *supra* note 32, at 15,449. If there is a conflict, the 2007 statement "supersedes" the old one. *Id.* Because nothing in the revised Rule conflicts with the Agency's endorsement of private actions, the endorsement continues.

[56] 15 U.S.C. § 45(a)(1) (2006).

[57] *See* Sovern, *supra* note 41, at 440-52 (contrasting consumer actions under state Little FTC Acts with Agency actions under the FTC Act).

public interest.[58] Some franchisees might use the section as a harassment tool, forcing their franchisors to defend against—and the courts to consider—essentially baseless claims of unfairness or deception. In at least in some cases, courts might respond by unduly restricting the section's scope.[59] Even if case law eventually defined unfairness and deception in franchise sales, the process could take many years.

Despite the generality of section five of the FTC Act, however, a private action under the Rule would not create an undue risk of vexatious litigation. The Rule contains both a detailed set of requirements for franchise disclosures[60] and instructions for preparing [61] and updating[62] disclosure documents. The Statement of Basis and Purpose includes a detailed section-by-section analysis of the Rule.[63] The Agency has also published a Compliance Guide, which explains aspects of the revised Rule that differ from earlier requirements.[64] The Guide includes sample disclosures that illustrate compliance.[65] With respect to site selection

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[58] *See id.* Sovern points to *Geismar v. Abraham & Strauss*, 439 N.Y.S.2d 1005 (N.Y. Dist. Ct. 1981), in which a newspaper published an advertisement for a set of dishes. The newspaper erred, and the published price was substantially less than the store's actual retail price. The store refused to sell at the lower price to a consumer who had seen the advertisement. The consumer sued the store and was able to recover statutory damages under New York's Little FTC Act. *Geismar*, 439 N.Y.S.2d at 1006-08. As Sovern notes, there was no way the store could have prevented the deception. Arguably, then, there is no deterrence rationale for the holding, although perhaps the store could have recovered its loss from the newspaper. Sovern, *supra* note 41, at 452. Moreover, the consumer may have been inconvenienced, but she was not injured. The breadth of the statute troubled the judge:

> The implications of this construction of the statute are awesome. Even running corrective advertising will not provide a defense by the terms of the section, other than to the extent it establishes that a person was not deceived or misled. Very little in the way of reliance on the misleading advertisement need be shown. Possible liability for a mistake in advertisements in [a] newspaper . . . widely disseminated could be virtually limitless. But, it does seem that this is the mandated result. [New York's Little FTC Act] may be in need of legislative review and revision.

Geismar, 439 N.Y.S.2d at 1008. The current version of the statute is essentially the same as the one that controlled in the case. *See* N.Y. GEN. BUS. LAW §§ 350-a, 350-e (McKinney 2004 & Supp. 2008).

[59] *See* Sovern, *supra* note 41, at 457-62.

[60] *See* 16 C.F.R. § 436.5 (2008).

[61] *Id.* § 436.6.

[62] *Id.* § 436.7.

[63] 2007 Statement of Basis & Purpose, *supra* note 32, at 15,453-538.

[64] Federal Trade Commission, Franchise Rule-2008 Compliance Guide, http://www.ftc.gov/bcp/edu/pubs/business/franchise/bus70.pdf (2008).

[65] *Id. passim.* The Guide does note that its "advice is not binding on the [Agency]." *Id.* at ii. It also notes that franchisors can consult "'Amended Franchise Rule FAQ's' on the

assistance, for example, the sample disclosure in the Guide is much more carefully conceived and phrased than the one Paula's included in its disclosure document. In the sample, the franchisor discloses both its site selection criteria and the site selection services it provides. The franchisor makes no claim of site selection expertise.[66] A careful examination of the sample provision might well have led Paula's to omit any claim of expertise from its disclosure document and to include specifics regarding its site selection criteria and the services it would provide. Brown might then have been less inclined to rely on Swift's work, and she might have declined to buy a franchise to be operated at the inappropriate site he approved.

Despite the force of Brown's arguments, she will almost certainly lose if she sues to enforce the FTC Rule against Paula's. The Supreme Court is currently much less inclined to imply private actions than courts were in earlier eras. Erwin Chemerinsky writes that "[u]nder current law, it appears that the . . . Court will establish private actions only if affirmative evidence shows that Congress intended to allow such suits."[67] Chemerinsky explains that both separation of powers and federalism concerns underlie the Court's current approach.[68] Writing for the Court in 2001, Justice Scalia emphasized the limited nature of the Court's role:

FTC's web site . . . and staff opinions that have been issued in response to specific requests regarding particular fact situations." *Id.* at i.

[66] The sample disclosures are by a hypothetical franchisor named Belmont, which franchises muffler shops. The sample concerning site selection assistance describes what Belmont will do before the prospective franchisee ("you" in the sample) opens his or her business:

> Assist you in selecting a business site . . . . You select your business site within your exclusive area subject to our approval. Your site must be at least 8000 square feet, must have parking spaces, and must have an average of 250 cars per hour driving by. Although not required by the Franchise Agreement to do so, Belmont assists in site selection by telling you the number of new car registrations, population density, traffic patterns, and the proximity of the proposed site to other Belmont Muffler Shops. We must approve or disapprove your site within 20 days after we receive notice of the proposed location.

Id., Sample Item 11, at 69.

[67] ERWIN CHEMERINSKY, FEDERAL JURISDICTION § 6.3, at 388 (4th ed. 2003). *See also* Stabile, *supra* note 47, at 873.

[68] *Id.*, at § 6.3, at 380. *See also* Stoneridge Inv. Partners v. Scientific-Atlanta, Inc., 128 S. Ct. 761, 773 (2008). In *Stoneridge*, Justice Kennedy wrote for the Court that "[t]he determination of who can seek a remedy has significant consequences for the reach of federal power" and quoted from an earlier opinion in which the Court had explained that the "requirement of congressional intent 'reflects a concern, grounded in separation of powers, that Congress rather than the courts controls the availability of remedies for violations of statutes.'" *Id.*

> Implicit in our discussion thus far has been a particular understanding of the genesis of private causes of action. Like substantive federal law itself, private rights of action to enforce federal law must be created by Congress. The judicial task is to interpret the statute Congress has passed to determine whether it displays an intent to create not just a private right but also a private remedy. Statutory intent on this latter point is determinative. Without it, a cause of action does not exist and courts may not create one, no matter how desirable that might be as a policy matter, or how compatible with the statute.[69]

The Court's role, Scalia emphasized, does not depend on the prevailing judicial view of private actions at the time of enactment of the statute in question.[70] The contemporary "legal context matters only to the extent it clarifies [statutory] text."[71] The Supreme Court reaffirmed those views in a 2008 opinion by Justice Kennedy.[72]

In determining congressional intent, the Court has reasoned that "[s]tatutes that focus on the person regulated rather than the individuals protected create 'no implication of an intent to confer rights on a particular class of persons.'"[73] Because the FTC Act and the Rule focus on the franchisor, they arguably do not imply an intent to confer rights on franchisees.

As early as 1984, a federal district court adopted essentially the Supreme Court's current view and rejected a private action under the FTC Rule. In *Freedman v. Meldy's*,[74] the United States District Court for the Eastern District of Pennsylvania concluded that there was no reason to believe that Congress had intended to give a private action to parties injured by violations of the FTC Act.[75] Indeed, there was evidence that some members of Congress believed the FTC had become unduly aggressive in its rule making.[76]

The court in *Freedman* noted that, in earlier opinions denying private actions under the FTC Act, courts had expressed the fear that private enforcement would compromise Agency enforcement. After the decisions in those earlier cases, however, the Agency promulgated the Rule

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[69] Alexander v. Sandoval, 532 U.S. 275, 286-87 (2001) (citations omitted).
[70] *Id.* at 287-88.
[71] *Id.* at 288.
[72] *See Stoneridge*, 128 S. Ct., at 772-73 (2008). For criticism of the Court's approach, see Stabile, *supra* note 47, at 877-85. Stabile argues that congressional intent should be only one of the factors courts take into account in deciding whether to recognize private actions under federal statutes. *Id.* at 901-08.
[73] *Alexander*, 532 U.S. at 289 (citing Cal. v. Sierra Club, 451 U.S. 287, 294 (1981)).
[74] 587 F. Supp. 658 (E.D. Pa. 1984).
[75] *Id.*
[76] *Id.* at 661.

and publicized its view that the success of its own enforcement efforts depended on private enforcement.[77] The *Freedman* court appreciated both the force of that argument and the analogy to securities laws under which courts have recognized implied private actions:

> [W]hat effect does the FTC's expressed view, that there is a private cause of action under the new regulations, have on prior court decisions as to congressional intent? The question is particularly interesting in light of the following: [the holding in a leading case which held that there was no private action] relied in large part upon the rationale that private enforcement of the [FTC] Act would upset the FTC's enforcement scheme. The FTC, under the new regulations, opines that enforcement of its new rules will be ineffective without private enforcement. The new rules are analogous to the Securities Exchange Commission Rules on disclosure which have been held to be enforceable by private right of action. Disclosure rules are precisely the type of rules difficult to enforce by agency action alone.[78]

Despite the force of those arguments, the court was "constrained" to reject the private action because there was no evidence that Congress had adopted the FTC's view.[79] The court also rejected the argument that it could imply a private action under the Rule even if there was none under the FTC Act. The Supreme Court had "explicitly rejected arguments that the rules adopted under a statute can themselves provide the source of an implied damages remedy if the statute itself cannot."[80] As a result, the *Freedman* court dismissed the franchisee's complaint for violation of the FTC Rule. Other courts have agreed,[81] and today there is little or no chance that Brown could hold Paula's liable under the Rule.[82]

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[77] *Id.* at 660.

[78] *Id.* at 660.

[79] *Freedman*, 587 F. Supp. at 660, 662.

[80] *Id.* at 661-62. The Supreme Court reaffirmed that point in 2001: "regulations, if valid and reasonable, authoritatively construe the statute itself, and it is therefore meaningless to talk about a separate cause of action to enforce the regulations apart from the statute." Alexander v. Sandoval, 532 U.S. at 284 (2001) (citations omitted); *id.* at 291 ("Language in a regulation may invoke a private right of action that Congress through statutory text created, but it may not create a right that Congress has not.").

[81] *See* Mercy Health Sys. v. Metro. Partners Realty, No. 02-1015, 2002 U.S. Dist. LEXIS 14080 (E.D. Pa. July 29, 2002); Layton v. AAMCO Transmissions, 717 F. Supp. 368 (D. Md. 1989); Days Inn of Am. Franchising v. Windham, 699 F. Supp. 1581 (N.D. Ga. 1988); Mon-Shore Mgmt. v. Family Media, Nos. 83 Civ. 2013, 83 Civ. 2014, 83 Civ. 5548, 83 Civ. 5550, 1985 WL 4845 (S.D.N.Y. Dec. 23, 1985).

[82] *See* JONATHAN SHELDON & CAROLYN L. CARTER, UNFAIR AND DECEPTIVE ACTS AND PRACTICES § 9.1 (6th ed. 2004) (Notwithstanding the Agency's stance favoring private

ii. Negligence Per Se

Brown can argue that Paula's violation of the FTC Rule constitutes negligence per se under state law. She will argue that the Rule establishes a standard of reasonableness in preparing franchise disclosures and that the company's failure to meet that standard constituted negligence as a matter of law. Depending on the jurisdiction, she may need to make a less ambitious argument: that evidence of the violation should go to the fact finder. If the court agrees with either argument, she may be able to achieve essentially the same result as if there had been a private action under the Rule.[83]

Brown can cite section 286 of the Restatement (Second) of Torts, entitled "When Standard of Conduct Defined by Legislation or Regulation Will Be Adopted":

> The court may adopt as the standard of conduct of a reasonable [person] the requirements of a legislative enactment or an administrative regulation whose purpose is found to be exclusively or in part
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> (a) to protect a class of persons which includes the one whose interest is invaded, and
>
> (b) to protect the particular interest which is invaded, and
>
> (c) to protect that interest against the kind of harm which has resulted, and

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actions, "courts have consistently held that it is for Congress and the courts, not the FTC, to decide if there is a private right of action under an FTC rule, and since there is no evidence that Congress changed its mind, the FTC Statement of Basis and Purpose should be given no effect." (footnote omitted)). The authors cite cases in support of the observation that "judicial precedent, with only a few exceptions, indicates that there is no private right of action under the FTC Act." *Id.* (footnote omitted).

[83] *See* James M. Beck & John A. Valentine, *Challenging the Viability of FDCA-Based Causes of Action in the Tort Context: The Orthopedic Bone Screw Experience*, 55 FOOD & DRUG L.J. 389, 405-06 (2000) ("Aside from the effect upon federal question jurisdiction, there is little to distinguish between a claim of negligence *per se* and an implied private right of action; they are essentially two means of applying a statute to achieve the same result." (footnote omitted)); Stabile, *supra* note 47, at 865 n.19 ("Although the negligence per se claim is not the same as an implied cause of action—in the former the cause of action is a state law tort claim, whereas the latter is a federal statutory cause of action—the two claims get the plaintiff to the same place.").

> (d) to protect that interest against the particular hazard from which the harm results.[84]

The purpose of the FTC Rule is to protect the class of prospective franchisees, which includes Brown. The Rule is designed to protect her interest in full and accurate disclosure—an interest that Paula's has invaded. The Agency promulgated the Rule to protect that interest from the harm that results from the purchase of a franchise that cannot be made profitable, and Brown has suffered that harm. Moreover, Paula's misinformation exposed her to the hazards of an uninformed decision about whether to join the company's system—the very hazards that the Agency had in mind.[85] The court should therefore adopt the Rule's requirements as the standard of care for purposes of Brown's negligence claim.

At least one court has held that a violation of a disclosure requirement can constitute negligence per se. In *Alaface v. National Investment Co.*,[86] the seller of a building lot in an Arizona subdivision was statutorily required, before offering the lot for sale, to send a notice to the State Real Estate Commissioner. The statute required that the notice contain a "true statement" of the water and other utilities that would service the lot.[87] After examining the subdivision, the Commissioner would issue a public report which would authorize the sale and set forth the information the seller had provided. The statute required the seller to give a copy of the report to the buyer.

The seller of a lot which had no water supply failed to send a notice to the Commissioner. The buyer, who, as the seller knew, planned to build a house on the lot, discovered the lack of water only after buying the property, and sued the seller.[88] The Arizona appellate court held that the seller had violated the notice requirement, but that the only statutory remedy was rescission.[89]

The buyer was, however, entitled to recover damages under the common law for negligence per se. Observing that Arizona courts followed the Restatement section,[90] the court found that the buyer's case came within its provisions. The disclosure statute was designed "to protect members of the public from being misled into purchasing land that is unusable or unsafe for residential purposes."[91] Moreover, the Restatement illustrations made

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[84] RESTATEMENT (SECOND) OF TORTS § 286 (1977). *See also id.* at § 285 ("The standard of conduct of a reasonable [person] may be . . . adopted by the court from a legislative enactment or an administrative regulation which does not so provide . . . .").
[85] *See* 2007 Statement of Basis and Purpose, *supra* note 32, at 15,447, 15,450-52.
[86] 892 P.2d 1375 (Ariz. Ct. App. 1994).
[87] *Id.* at 1381.
[88] *Id.* at 1377-78.
[89] *Id.* at 1381-83.
[90] *Id.* at 1385.
[91] *Alaface*, 892 P.2d at 1385-86.

clear that negligence per se could be premised on economic harm as opposed to personal injury. Violation of what the dissenting judge termed a "safety statute" was not required.[92]

Courts in other states may reject the Arizona courts' view for one or both of two reasons. First, Paula's can argue with some force that the Restatement section contemplates negligence liability based on violations of statutes or regulations designed to enhance public safety.[93] As a result, a court would have to strain in order to apply the section to a case like Brown's. In *Lowdermilk v. Vescovo Building & Realty*,[94] for example, buyers of a home in Missouri sued the seller's brokers for negligence per

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[92] *Id.* at 1386-87. *See also* 1 DOBBS, *supra* note 24, § 134, at 318 ("Even statutes regulating economic relations of the parties, such as those requiring disclosure of specific information, have been held to be the basis of a negligence per se claim." (footnote omitted) (citing Alaface v. Nat'l Inv. Co., 892 P.2d 1375 (Ariz. Ct. App. 1994)). In Lombardo v. Albu, 4 P.3d 395 (Ariz. Ct. App. 1999), however, the court declined to permit a real estate seller to base a claim for damages on a regulation that imposed a duty of disclosure on a real estate broker acting for the buyer. The court explained:

> [T]he existence of an administrative regulation does not necessarily mean that a duty exists that, if breached, gives rise to liability in tort. The regulations at issue are similar to the Rules of Professional Conduct regulating attorneys, which were "not designed to be a basis for civil liability," but to "provide guidance to lawyers and to provide a structure for regulating conduct through disciplinary agencies."

Id. at 397. "The reason that courts do not impose tort liability in every instance in which someone violates an administrative regulation is this: The policies implicated when considering tort liability can differ from those in deciding regulatory policy." *Id.* at 399. *Lombardo* demonstrates that a violation of a disclosure regulation will not necessarily be a basis for negligence liability in Arizona. A factor that militated against imposition of a duty in that case, however, was the conflict of interest the duty might create for the real estate broker. *Id.* That factor is not present in Brown's case.

[93] Dan Dobbs writes that "[t]he negligence per se rule is commonly adopted in motor vehicle cases." 1 DOBBS, *supra* note 24, § 134. He adds:

> Although courts refuse to adopt the statutory standard in some cases, and especially when the statute imposes certain affirmative obligations, the negligence per se rule is applied to a wide variety of statutory violations. A statute requires a lifeguard at a pool, lights on a ship, buildings constructed to specific requirements, safety devices for protection of construction workers, smoke detectors for the protection of tenants; violation is negligence per se. Statutes regulating sales or dispensation of dangerous items like guns and alcohol may also sometimes furnish grounds for a negligence claim by persons injured as a result of the sale.

Id. (footnotes omitted).

[94] 91 S.W.3d 617 (Mo. Ct. App. 2002).

se, and a Missouri appellate court rejected their claim. The buyers alleged that the brokers had violated a statute that required disclosure of "all adverse material facts"[95] concerning the property of which the brokers were or should have been aware. Defects that should have been disclosed led to losses, the buyers claimed, so the brokers were liable for negligence per se. The court disagreed. The statute fell "outside the class of safety statutes on which negligence per se is ordinarily based."[96] That doctrine had "traditionally arisen in cases involving personal injury and physical injury to property," and not in "cases which involve[d] damage to economic interests."[97] Moreover, the statute expressly provided that it did not limit "civil actions for negligence, fraud, misrepresentation or breach of contract."[98] The legislature had not intended, the court reasoned, to "allow a plaintiff to collect damages for fraud, misrepresentation, or failure to disclose without proving all of the traditional elements of those claims."[99]

Second, Paula's can argue that Brown's attempt to use the FTC Rule as a basis for a state common law claim should fail under the Supremacy Clause in the Federal Constitution. If the Rule violation constitutes negligence per se under state law, the state has effectively created a private action in the teeth of the federal cases holding that no such action exists.[100] Paula's can cite *Sanford Street Local Development Corp. v. Textron*,[101] in which a federal district court refused to recognize a violation of the federal Toxic Substances Control Act (TSCA) as the basis of a negligence per se action for damages under Michigan law. Congress had provided for injunctive remedies but not for damages under the TSCA, and the federal scheme preempted the state law:

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[95] *Id.* at 628 (quoting MO. REV. STAT. § 339.730.3 (Supp. 1998)).
[96] *Id.* at 628.
[97] *Id. See also* Foy, *supra* note 49, at 568 ("State courts seem to have special difficulty with cases that lack the usual earmarks of negligence cases.").
[98] *Id.*, at 629 (quoting MO. REV. STAT. § 339.840 (1998)).
[99] *Lowdermilk,* 91 S.W.3d at 629 (quoting MO. REV. STAT. § 339.840 (1998)).
[100] *Cf.* Louis Loss, *The SEC Proxy Rules and State Law*, 73 HARV. L. REV. 1249, 1275-76 (1960). Loss argues in favor of concurrent state and federal court jurisdiction over implied private actions under section 27 of the Securities Exchange Act, 15 U.S.C. § 78aa (2006). If federal and state courts shared jurisdiction, he writes,

> the question whether the private right of action is created by the federal common law or the state common law would be a highly interesting jurisprudential problem, but nothing more; for the state courts would merely be instruments for the application of federal law, and any different notions worked out under state tort concepts would have to yield under the supremacy clause in any case.

Id.
[101] 768 F. Supp. 1218 (W.D. Mich. 1991).

> Although a violation of a statute will not necessarily lead to a verdict for the plaintiff, it is nonetheless clear that the success of a cause of action alleging negligence *per se* is largely controlled by the existence of such an event. As such, a negligence *per se* claim alleging a violation of the TSCA is little different than an implied right of action under the TSCA for money damages. Since the latter is not available because of Congress' desire to provide aggrieved parties with only equitable remedies, this Court finds that the former is preempted as well. Otherwise, the common law of Michigan would be in direct conflict, on its face, with federal law, a situation prohibited by the Supremacy Clause.[102]

The court in Brown's case should arguably reject her negligence per se claim for the same reason.[103]

In some cases, however, courts have held that violations of federal law can constitute negligence per se under state law. Consider *Lowe v. General Motors Corp.*,[104] in which evidence of a violation of the federal National Traffic and Motor Vehicle Safety Act[105] was evidence of negligence per se in a state wrongful death action. The federal district court hearing the case on the basis of diversity—and not federal question—jurisdiction, concluded that there was "no private remedy for negligence under [that Act]."[106] On appeal, the Fifth Circuit did not disagree but held that the violation could nevertheless provide the basis for a negligence per se action under Alabama law:

> This court has often held that violation of a Federal law or regulation can be evidence of negligence, and even evidence of negligence per se.
>
> The mere fact that the law which evidences negligence is Federal while the negligence action itself is brought under State common law does not mean that the

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[102] *Id.* at 1224. The court reached its conclusion despite the following language in the section of the TSCA that provided for injunctive enforcement: "Nothing in this section shall restrict any right which any person (or class of persons) may have under any statute or common law to seek enforcement of this chapter or any rule or order under this chapter or to seek other relief." 15 U.S.C. § 2619(c)(3) (2006).

[103] *See* Beck & Valentine, *supra* note 83, at 409-16 (describing a majority rule rejecting negligence per se and a minority rule endorsing the doctrine in the context of the Food, Drug, and Cosmetic Act, 21 U.S.C. §§ 301-399 (2000 & Supp. 2005)).

[104] 624 F.2d 1373 (5th Cir. 1980).

[105] 49 U.S.C. §§ 30101-30170 (2000 & Supp. 2005).

[106] *Lowe*, 624 F.2d at 1378.

> state law claim metamorphoses into a private right of action under Federal regulatory law.[107]

At least one other court has reached the same conclusion.[108]

In sum, Brown may or may not be able to sue for negligence *per se*. Her ability or inability to do so will depend primarily on her jurisdiction.[109]

iii. State Disclosure Laws

Fourteen states have enacted statutes requiring franchisor disclosures to prospective franchisees.[110] One other state maintains an administrative regulation requiring disclosure.[111] Twelve of the fourteen states also require registration of disclosure documents.[112] If Brown's case is governed by the law of one of the fifteen, Paula's may have violated not only the FTC Act but also the applicable state disclosure law. Each of the laws gives a franchisee injured by a violation a private action for damages,[113] and in some states the franchisee may also be entitled to

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[107] *Id.* at 1379.

[108] *See* Lukaszewicz v. Ortho Pharm. Corp., 510 F. Supp. 961, 964-65 (E.D. Wis.), *opinion and order amended* 532 F. Supp. 211 (E.D. Wis. 1981) (Wisconsin follows Restatement (Second) of Torts § 286; violation of federal regulation concerning oral contraceptives can constitute negligence per se.).

[109] *Cf.* William W. Watts, *Common Law Remedies in Alabama for Contamination of Land*, 29 CUMB. L. REV. 37, 58 (1998) ("Some courts have allowed claims of negligence per se for land contamination caused by violation of environmental statutes. Other courts, however, have refused to recognize a negligence per se action for violation of environmental regulations . . . .").

[110] CAL. CORP. CODE § 31119 (West Supp. 2008); HAW. REV. STAT. ANN. § 482E-3 (West 2008); 815 ILL. COMP. STAT. ANN. 705/5(2) (West Supp. 2008); IND. CODE ANN. § 23-2-2.5-9(2) (LexisNexis 1999); MD. CODE ANN., BUS. REG. § 14-223 (LexisNexis 2004); MICH. COMP. LAWS SERV. § 445.1508 (LexisNexis Supp. 2008); MINN. STAT. ANN. § 80C.06(5) (West Supp. 2008); N.Y. GEN. BUS. LAW § 683(8) (McKinney 1996); N.D. CENT. CODE § 51-19-08(6) (2007); R.I. GEN. LAWS § 19-28.1-8(a) (2006); S.D. CODIFIED LAWS § 37-5B-5B-17(1) (2008); VA. CODE ANN. § 13.1-563(e) (2006); WASH. REV. CODE ANN. § 19.100.080 (West 1999); WIS. STAT. ANN. § 553.27(4) (West 2006).

[111] OR. ADMIN. R. § 441-325-020 (2008).

[112] CAL. CORP. CODE § 31110 (West 2006); 815 ILL. COMP. STAT. ANN. 705/10 (West 1999); IND. CODE ANN. § 23-2-2.5-9(1) (LexisNexis 1999); MD. CODE ANN., BUS. REG. § 14-214 (LexisNexis 2004); MINN. STAT. ANN. § 80C.02 (West 1999); N.Y. GEN. BUS. LAW § 683(1) (McKinney 1996); N.D. CENT. CODE § 51-19-03 (2007); R.I. GEN. LAWS § 19-28.1-5 (2006); S.D. CODIFIED LAWS § 37-5B-4 to -5 (2008); VA. CODE ANN. § 13.1-560 (Supp. 2008); WASH. REV. CODE ANN. § 19.100.020 (West 1999); WIS. STAT. ANN. § 553.21 (West 2006).

[113] *See* CAL. CORP. CODE § 31300 (West 2006); HAW. REV. STAT. ANN. § 482E-9(b) (West 2008); 815 ILL. COMP. STAT. ANN. 705/26 (West 1999); IND. CODE ANN. § 23-2-2.5-28 (LexisNexis 1999); MD. CODE ANN., BUS. REG. § 14-227 (LexisNexis 2004); MICH. COMP. LAWS SERV. § 445.1531(1) (LexisNexis 2006); MINN. STAT. ANN. § 80C.17(1) (West Supp. 2008); N.Y. GEN. BUS. LAW § 691(1) (McKinney 1996); N.D. CENT. CODE § 51-19-12(1) (2007); R.I. GEN. LAWS § 19-28.1-21(a) (2006); S.D. CODIFIED LAWS § 37-5B-49 (2008); VA. CODE ANN. § 13.1-571 (2006); WASH. REV. CODE ANN. § 19.100.190(2) (West 1999); WIS. STAT. ANN. § 553.51(2) (West 2006).

rescission.[114] Some of the statutes also enable aggrieved franchisees to obtain attorneys' fees in certain circumstances.[115] One advantage of the statutory action over a common law fraud action may be that in the statutory action Brown will not need to prove scienter.[116]

Even if Brown's jurisdiction is one of the fifteen, however, her franchise purchase may have been exempt from the disclosure law's coverage.[117] There may be a provision in the Franchise Agreement stating that she and Paula's have chosen to be governed by the law of a different jurisdiction.[118] Moreover, she may be unable to recover damages if Paula's offers her rescission of the contract and restitution of the funds she has

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In Oregon, an administrative regulation, OR. ADMIN. R. § 441-325-020(4) (2008), provides that failure to provide a disclosure statement, as required by OR. ADMIN. R. § 441-325-020(1) (2008), is a violation of the state statute which requires truth in franchise sales, OR. REV. STAT. ANN. § 650.020(1) (West Supp. 2008). The statute gives the franchisee a private action against the franchisor. OR. REV. STAT. ANN. § 650.020(1) (West Supp. 2008). The damages allowed under the statute are "any amounts to which the franchisee would be entitled upon an action for a rescission." *Id.* § 650.020(3).

[114] *See* CAL. CORP. CODE § 31300 (West 2006); HAW. REV. STAT. ANN. § 482E-9(b) (West 2008); 815 ILL. COMP. STAT. ANN. 705/26 (West 1999); MD. CODE ANN. § 14-227(c)(1) (LexisNexis 2004); MICH. COMP. LAWS SERV. § 445.1531(1) (LexisNexis 2006); MINN. STAT. ANN. § 80C.17(1) (West Supp. 2008); N.Y. GEN. BUS. LAW § 691(1) (McKinney 1996); N.D. CENT. CODE § 51-19-12(1) (2007); R.I. GEN. LAWS § 19-28.1-21(a) (2006); S.D. CODIFIED LAWS § 37-5B-49 (2008); WASH. REV. CODE ANN. § 19.100.190(2) (West 1999); WIS. STAT. ANN. § 553.51(1) (West 2006).

See also OR. REV. STAT. ANN. § 650.020(3) (West Supp. 2008) ("The franchisee may recover any amounts to which the franchisee would be entitled upon an action for a rescission.") *and* OR. ADMIN. R. § 441-325-020(4) (2008).

[115] *See* HAW. REV. STAT. ANN. § 482E-9(c) (West 2008); 815 ILL. COMP. STAT. ANN. 705/26 (West 1999); IND. CODE ANN. § 23-2-2.5-28 (LexisNexis 1999); MINN. STAT. ANN. § 80C.17(3) (West Supp. 2008); N.Y. GEN. BUS. LAW § 691(1) (McKinney 1996); N.D. CENT. CODE § 51-19-12(3) (2007); R.I. GEN. LAWS § 19-28.1-21(a) (2006); S.D. CODIFIED LAWS § 37-5B-49 (2008); VA. CODE ANN. § 13.1-571(a) (2006); WASH. REV. CODE ANN. § 19.100.190(3) (West 1999). *See also* OR. REV. STAT. ANN. § 650.020(3) (West Supp. 2008).

[116] *See* 2 GARNER, *supra* note 6, § 9:12 ("Under state franchise disclosure statutes, the scienter requirement may be relaxed."). For discussion of the scienter requirement in common law fraud actions, see *infra* text at notes 137-38.

[117] *See, e.g.*, CAL. CORP. CODE §§ 31100 to 31109.1 (West 2006); HAW. REV. STAT. ANN. § 482E-4 (West 2008); 815 ILL. COMP. STAT. ANN. 705/9 (West 1999) (administrator may grant exemptions). *See generally* 1 GARNER, *supra* note 6, §§ 5A:22 to 29.

[118] *See, e.g.*, 3 GARNER, *supra* note 6, § 17:23 ("Where there are no statutory provisions against choice of law clauses, such clauses have been widely enforced in a broad range of franchise and dealer relationships."). As applied to the state disclosure law, however, the clause may be unenforceable. *See* Holland, et al., *supra* note 24, at 16 (noting that many of the disclosure statutes contain "anti-waiver" provisions). For general discussion of the effectiveness of choice of law clauses, see *id.* at 35-38.

paid,[119] or she may be held to have waived her rights by retaining the franchise for a time after realizing that the site was unsuitable.

iv. State Unfair Trade Practices Acts

Another possibility for Brown is to claim that Paula's violation of the FTC Rule is a violation of the state unfair trade practices or "Little FTC Act" in her jurisdiction. If she does, the first question will be whether she qualifies for protection under that Act.[120] Jonathan Sheldon and Carolyn Carter write that "[c]ourts usually find that the sale of a franchise to a franchisee is covered by [the state Little FTC Act]," but also that there are contrary decisions.[121] In many states, Little FTC Acts protect only consumers,[122] and define a consumer as a person who buys goods or services primarily for personal, family, or household purposes.[123] Brown arguably bought her franchise for business purposes, so the court may regard her as a businessperson rather than a consumer.[124] If so her jurisdiction's Little FTC Act may not apply.

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[119] *See, e.g.*, MICH. COMP. LAWS SERV. § 445.1531(2) (LexisNexis 2006). *See generally* 1 GARNER, *supra* note 6, § 5A:42.

[120] *See generally* 62B AM. JUR. 2D *Private Franchise Contracts* § 164 (2005 & Supp. 2008).

[121] SHELDON & CARTER, *supra* note 82, § 2.2.9.2.

[122] *See* ROBERT M. LANGER ET AL., 12 CONNECTICUT PRACTICE SERIES, UNFAIR TRADE PRACTICES App. K, at K-9 to K-11 (Supp. 2007) (table entitled "Types of Conduct Prohibited by and Availability of Private Remedies in State Unfair and Deceptive Trade Practices Acts").

[123] *See* SHELDON & CARTER, *supra* note 82, § 2.1.8.1.

[124] *See* 2 GARNER, *supra* note 6, § 9:34, at 9-117 ("Some [Little FTC] acts limit relief to consumers, which may be construed to exclude franchisees, almost certainly franchisors, and sometimes all corporations." (footnote omitted)). In *J & R Ice Cream v. California Smoothie Licensing*, 31 F.3d 1259, 1270-74 (3rd Cir. 1994), the Third Circuit rejected a franchisee's claim of a violation of the New Jersey Consumer Fraud Act, N.J. STAT. ANN. § 56:8-2 (West 1989):

> We conclude that even where franchises or distributorships are available to the public at large in the same sense as are trucks, boats or computer peripherals, they are not covered by the Consumer Fraud Act because they are businesses, not consumer goods or services. They never are purchased for consumption. Instead, they are purchased for the present value of the cash flows they are expected to produce in the future and . . . bear no resemblance to the commodities and services listed in the statutory definition of "merchandise" or the rules promulgated by the Division of Consumer Affairs.

Id. at 1274 (footnotes omitted). *But see* Kavky v. Herbalife Int'l of Am., 820 A.2d 677 (N.J. Super. Ct. App. Div. 2003) (holding that the New Jersey Little FTC Act does apply to the sale of a franchise).

See also, e.g., Holland, et al., *supra* note 24, at 20-21, 31-32; Dennis D. Palmer, *Franchises: Statutory and Common Law Causes of Action in Missouri Revisited*, 62 UMKC L. REV. 471, 497 (1994). Palmer writes:

If Brown can sue, the next question will be whether she can prove a violation. Sheldon and Carter maintain that a violation of the FTC Rule should be a "*per se* . . . violation" of an applicable Little FTC Act.[125] Florida's Act states that a violation "may be based upon . . . [a]ny law, statute, rule, regulation, or ordinance which proscribes unfair methods of competition, or unfair, deceptive, or unconscionable acts or practices."[126] In some states, a violation of the FTC Rule is prima facie evidence of a violation of the Little FTC Act.[127] In some cases, however, courts have declined to find per se violations.[128]

If the Rule violation alone is insufficient, Brown may need to prove scienter,[129] although the court may interpret that requirement "narrowly."[130]

> Under the [Missouri Little FTC Act], private civil actions for persons injured as a result of unlawful practices are limited to transactions "primarily for personal, family or household purposes." This limitation probably precludes a private right of action for practices affecting franchising arrangements because franchising involves the purchase of goods and services primarily for commercial purposes and not for consumer purposes.

Id. (footnote omitted). A court's view of a franchisee as a businessperson rather than a consumer may also increase the likelihood of enforcement of a waiver of the protections of a Little FTC act. *See* Holland et al., *supra* note 24, at 39.

For criticism of contract law's dichotomy between merchants and consumers, see Larry T. Garvin, *Small Business and the False Dichotomies of Contract Law*, 40 WAKE FOREST L. REV. 295 (2005). Garvin argues that the dichotomy disadvantages small businesses. The law treats them as equals in their dealings with larger businesses. In their dealings with consumers, however, it requires them to "give protections based on asymmetries that may not exist." *Id.* at 297. The law thus "may effectively subject small businesses to a regulatory tax—a peculiar tax indeed, if small businesses are, as we are told, the driving forces of our economy." *Id.* (footnote omitted).

[125] SHELDON & CARTER, *supra* note 82, § 5.13.1.1.

[126] FLA. STAT. ANN. § 501.203(a) (West Supp. 2008).

[127] 2 GARNER, *supra* note 6, § 9:36, at 9-136.

[128] *See, e.g.*, Symes v. Bahama Joe's, Inc., No. 87-0963-Z, 1988 WL 92462, at *5 (D. Mass. Aug. 12, 1988) ("Although [the Massachusetts Little FTC Act] allows courts, in construing unfair or deceptive acts or practices, to be guided by [sic] Federal Trade Commission's and Federal Courts' interpretations of § 5(a)(1) of the FTC Act, this does not mean that a violation of the Franchising Rules, *ipso facto*, leads to a violation of [the Massachusetts Little FTC Act]."); LeBlanc v. Belt Ctr., Inc., 509 So.2d 134, 137 (La. App. 1987) ("We agree with the trial court that the failure to comply with the FTC disclosure regulations did not constitute an unfair trade practice.").

[129] *See* SHELDON & CARTER, *supra* note 82, § 4.2.4.2; Victor E. Schwartz & Cary Silverman, *Common-Sense Construction of Consumer Protection Acts*, 54 KAN. L. REV. 1, 20 (2005). In *Brennan v. Carvel Corp.*, 929 F.2d 801 (1st Cir. 1991), Carvel represented that its site selection personnel were experts, but the employee who approved a site for the Brennans was not an expert. *Id.* at 803-05. As a result, the Brennans' store failed and they sued Carvel. *Id.* at 805. Despite the misrepresentation, the First Circuit concluded that "there was no evidence that Carvel intended to deceive or mislead the Brennans" and

In a "small minority" of states, she might need to prove that she relied on Paula's statements,[131] although there is authority for the proposition that no reliance is required "where the seller misstates a disclosure it is legally required to make."[132]

v. Common Law Misrepresentation

Yet another possibility for Brown is a common law misrepresentation action. Dan Dobbs summarizes the elements that the courts have traditionally required:

> Courts list anywhere from four to nine elements of the common law fraudulent misrepresentation claim, but whatever the number, they agree in substance that the plaintiff must prove (1) an intentional misrepresentation (2) of fact or opinion (as distinct from a promise) (3) that is material and (4) intended to induce and (5) does induce reasonable reliance by the plaintiff, (6) proximately causing pecuniary harm to the plaintiff. Procedurally, the plaintiff may be required to plead fraud with particularity. Many courts add that fraud must be proved by clear and convincing evidence, although a number say a preponderance of the evidence is sufficient, at least under some conditions.[133]

A successful misrepresentation action may culminate in an award of both compensatory and punitive damages.[134]

Brown will argue generally that the disclosure document she received misrepresented the expertise of Paula's personnel and the quality of the assistance she would receive. She will likely be able to prove materiality because site selection was critical to the success or failure of her store.[135] The disclosure document was clearly designed to induce her to buy a franchise, and it did induce her to do so. Moreover, she should be able to prove proximate cause with little difficulty, as her losses stemmed directly, and not remotely, from Swift's poor performance.[136]

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upheld the trial court's rejection of their claims under the Massachusetts Little FTC Act. *Id.* at 814. For criticism of the court's finding of no intent to deceive, see 2 GARNER, *supra* note 6, § 9:21, at 9-82.

[130] SHELDON & CARTER, *supra* note 82, § 4.2.4.2.

[131] *Id.* § 4.2.12.3.2.

[132] *Id.* § 4.2.12.3.3. *But see* Holland, et al., *supra* note 24, at 33-34 (proof of reliance may be required under the rubric of causation).

[133] 2 DOBBS, *supra* note 24, § 470 (footnotes omitted).

[134] *Id.* § 483.

[135] *Id.* § 476 ("Representations are material if a reasonable person would want to consider the fact represented in determining whether to enter the transaction in question . . . .").

[136] *See, e.g.*, RESTATEMENT (SECOND) OF TORTS § 548A (1977) ("A fraudulent misrepresentation is a legal cause of a pecuniary loss resulting from action or inaction in

The other elements Dobbs lists may prove more challenging, however. Consider the requirement that the misrepresentation be intentional—the requirement of scienter. The basic notion, as applied to Paula's, is that the company must have made the statements in the disclosure document without believing that they were true.[137] Brown may therefore need to prove that the company asserted that its site selection personnel were experts without believing that to be true. She may have difficulty meeting that requirement, particularly if the court requires proof by clear and convincing evidence.[138] Suppose, for example, that most of the site selection personnel, including Swift, were recent hires who had previously worked for a different franchisor. The manager who hired and supervised them at Paula's may have believed in their expertise, learning only after Brown's purchase that the decision to hire them was a mistake. The company will then escape liability even though it was much better positioned than Brown to discover their ineptitude.

If Brown can show that Paula's could have discovered the employees' lack of expertise by exercising ordinary care, and if courts in her jurisdiction allow recovery for negligent misrepresentation, she may be able to prevail under that doctrine.[139] In some states, however, the courts have not adopted that doctrine.[140] In states that have, moreover, the doctrine may apply only if there is a "special relationship" between the plaintiff and the defendant.[141] Fiduciary and other confidential relationships may well be special for this purpose, as may relationships in which one party "is retained for the very purpose of providing accurate information."[142] Most courts have declined to characterize franchisors as fiduciaries for their franchisees,[143] and a prospective franchisee is highly unlikely to qualify as the beneficiary of a fiduciary relation. Moreover, Brown did not retain Paula's, for the purpose of providing accurate information or otherwise. The court is likely to regard her relationship with

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reliance upon it if, but only if, the loss might reasonably be expected to result from the reliance.").

[137] 2 DOBBS, *supra* note 24, § 471.

[138] *See id.*, § 470 (footnotes omitted).

[139] Michael Garner adds that "[n]egligent misrepresentation may form the basis of an action under certain 'little FTC Acts.'" 2 GARNER, *supra* note 6, § 9:14.

[140] 2 DOBBS, *supra* note 24, § 472.

[141] *Id.* ("[T]he ordinary commercial adversary bargainer ordinarily has no duty to use care in supplying information to those with whom he bargains. . . . Rather, a special relationship or some implicit undertaking to exercise care in investigating or communicating information is normally required." (footnotes omitted)).

[142] *Id.* at 1350.

[143] 2 GARNER, *supra* note 6, § 8:32 ("Virtually all of the courts that have addressed the issue have concluded that no fiduciary relationship is implied in a distributorship or a franchise relationship." (footnotes omitted)). *See also, e.g.*, Cottman Transmission Sys., L.L.C. v. Kershner, 536 F.Supp. 2d 543, 556 (E.D. Pa. 2008).

the company during the negotiation phase as having been at arms length, rather than as special for purposes of negligent misrepresentation.[144]

Another possibility is that the courts in Brown's jurisdiction are willing to base tort liability on innocent misrepresentations. A tort action for innocent misrepresentation is a close cousin of a contract action for breach of warranty.[145]

Section 552C of the Restatement (Second) of Torts provides as follows:

> (1) One who, in a sale, rental or exchange transaction with another, makes a misrepresentation of a material fact for the purpose of inducing the other to act or refrain from acting in reliance upon it, is subject to liability to the other for pecuniary loss caused to him by his justifiable reliance upon the misrepresentation, even though it is not made fraudulently or negligently.
>
> (2) Damages recoverable under the rule stated in this section are limited to the difference between the value of what the other has parted with and the value of what he has received in the transaction.[146]

As the Restatement commentary implicitly acknowledges, not all courts have endorsed the action.[147] Moreover, Fowler Harper, Fleming James, and Oscar Gray cite various procedural vehicles that plaintiffs have employed in order to recover for innocent misrepresentations, writing that historically "[e]ach . . . vehicle[] had limitations that were arbitrary in some situations," and characterizing the whole body of law as "a confusing patchwork."[148]

Brown's best hope under the heading of innocent misrepresentation may lie in a claim for rescission and restitution.[149] "Where this remedy is

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[144] 2 Garner, *supra* note 6, § 9:14 ("In general, a simple commercial relationship, such as that between a buyer and seller or a franchisor and franchisee does not ordinarily constitute a special relationship that will support a negligent misrepresentation claim.").

[145] *See* 2 DOBBS, *supra* note 24, § 473 (discussing warranty liability under the heading of "Innocent Misrepresentation").

[146] RESTATEMENT (SECOND) OF TORTS § 552C (1977).

[147] *See id.*, cmt. a (observing that the rule of the section is "reflected in the decisions of a number of American jurisdictions" and referring to "[t]he courts that apply [the] rule").

[148] 2 FOWLER V. HARPER ET AL., HARPER, JAMES AND GRAY ON TORTS § 7.7, at 493-94 (3d ed. 2006) (footnotes omitted). The procedural vehicles are "the equity suit for rescission, rescission at law, the action for breach of warranty, the action for fraud and deceit, and the doctrine of estoppel." *Id.* at 493.

[149] *See, e.g.*, Cousineau v. Walker, 613 P.2d 608, (Alaska 1980) (awarding rescission and restitution to a buyer of real estate on the basis of false representations concerning the real estate, in the absence of any evidence of negligence or intentional deception by the seller).

sought courts generally are willing to grant it on the basis of innocent, as well as culpable, misstatements; while the innocent misrepresenter may not deserve a penalty, he should not be allowed to benefit by a false statement at an innocent victim's expense."[150] The authors advocate damages as an alternative remedy in cases in which the injured party wishes to keep what he or she has purchased from the misrepresenter. Those damages, however, will be designed to prevent unjust enrichment of the misrepresenter rather than to protect the expectation interest of the injured party.[151]

Even as the basis for a rescission claim, moreover, an innocent misrepresentation action may be unavailable to Brown. If the court believes that Paula's misrepresentations were neither intentional nor negligent, it may conclude that tort liability is inappropriate.[152]

Consider next the second element in Dobbs's list of elements of a common law misrepresentation claim: the plaintiff must prove a misrepresentation "of fact or opinion (as distinct from a promise)." Brown will probably be able to prove that element with evidence of Paula's affirmation of its personnel's expertise, but not with evidence of the company's promise that prospective franchisees would receive expert site selection assistance. The conceptual difficulty lies in the orientation of promises, as opposed to representations. Whereas a representation concerns a present state of affairs, a promise is a statement of intention to act or refrain from acting in the future.[153] As such, a promise is untrue only insofar as it effectively misrepresents the promisor's intention.[154] To recover on the basis of Paula's promise, Brown would have to show that,

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For general discussion of rescission as a remedy in cases of improper disclosure, see Holland et al., *supra* note 24, at 40-46.

[150] HARPER ET AL., *supra* note 148, § 7.7, at 494 (footnotes omitted).

[151] *Id.* at 495.

[152] Some courts have reasoned essentially that the source of contracting parties' rights and obligations should be their contract and not the law of innocent misrepresentation:

> Some cases, a major Illinois case among them, have taken the view that the economic loss rule bars tort claims for innocent misrepresentation, but does not bar claims for intentional or negligent misrepresentation. A number of other cases, however, have barred both the claims for innocent and negligent representations [sic], leaving the plaintiff to recover, if at all, on the contract or for a tortious injury that was independent of the contract.

2 DOBBS, *supra* note 24, § 482B (Supp. 2008) (footnotes omitted).

[153] *See, e.g.*, RESTATEMENT (SECOND) OF CONTRACTS § 2 (1979).

[154] 2 DOBBS, *supra* note 24, § 479 ("[I]f the representation does not qualify as an enforceable contract, the plaintiff must prove that the statement of intention was false when it was made and nonperformance is not by itself sufficient for that."). *See also, e.g.*, Cook v. Little Caesar Enters., 210 F.3d 653, 658 (6th Cir. 2000) ("To establish fraud, the allegedly false statements must relate to past or existing facts, not to future promises or expectations.").

when the company gave her the disclosure document, it did not intend to provide her with expert site selection assistance. Even if that was in fact the case, Brown may be unable to satisfy her burden of proof on the issue.[155]

The fifth element in Dobbs's list—the need to prove reasonable reliance on the misrepresentation—may also prove problematic for Brown. She should be able to prove that she relied on Paula's affirmation regarding site selection, but she may have a more difficult time convincing the court that her reliance was reasonable. She will argue that it was reasonable because Paula's issued the disclosure document pursuant to the FTC Rule. The affirmation was a formal statement in a legally required document, the whole purpose of which was to provide reliable information to prospective franchisees.

Paula's will respond that, in accordance with the FTC Rule, the cover page of the document contained several statements addressed to Brown that should have led her to realize that she should not have relied solely on its contents:

> **Note . . . that no governmental agency has verified the information contained in this document.**[156]
>
> The terms of your contract will govern your franchise relationship. Don't rely on the disclosure document alone to understand your contract. Read all of your contract carefully. Show your contract and this disclosure document to an advisor, like a lawyer or an accountant.[157]
>
> Buying a franchise is a complex investment. The information in this disclosure document can help you make up your mind. More information on franchising . . . which can help you understand how to use this disclosure document, is available from the [FTC]. . . . Call your state

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[155] Dobbs suggests some types of evidence that might prove a misrepresentation of intention to perform:

> Direct evidence by way of the defendant's admission by documents showing that defendant planned not to perform, or circumstantial evidence that the defendant could not have raised funds necessary for the construction, or that he had already been denied necessary permits, or even that he had demonstrated a pattern of making representations that were never performed would tend to prove that he lacked the intention he represented.

2 DOBBS, *supra* note 24, § 479 (footnotes omitted).

[156] 16 C.F.R. § 436.3(e)(2) (2008).

[157] *Id.* at (e)(3).

> agency or visit your public library for other sources of information on franchising.[158]

If Brown did an independent investigation of the site's suitability, the court may believe that she relied on the results of that investigation as much as or more than the disclosure document. If she did not, the court may believe that she acted unreasonably, particularly given the warnings on the cover page of the document and the lack of any provision regarding site selection in the Franchise Agreement.[159]

Brown may respond that neither of the types of advisors the FTC recommends, nor any expert examining only the disclosure document and her Franchise Agreement, would have been able to tell whether Paula's site selection personnel were experts. Yet the court may conclude that she could have learned the truth, perhaps by consulting with existing franchisees. Rupert Barkoff writes that in cases of alleged fraud by franchisors, "the need to prove reliance and the reasonableness of that reliance are typically the major stumbling blocks for the aggrieved franchisee."[160]

In Alabama, Brown could probably use Paula's violation of the FTC Rule to help prove the elements of misrepresentation. In *Rodopoulos v. Sam Piki Enterprises*,[161] a franchisee alleged that it had purchased a pizza franchise on the basis of an inflated earnings claim. In a written projection and also orally, the franchisor had assured the franchisee that it could expect gross sales of approximately $12,000 per week, and that all it needed to break even was $7,000 per week. The franchisor apparently did not mention the sales of its only two operating stores, which had grossed only $4,000 to $5,000 per week.[162] Having bought a franchise and operated it, the franchisee suffered losses, closed the store, and sued the franchisor for misrepresentation. At the franchisee's request, the trial court instructed the jury as to the Rule:

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[158] *Id.* at (e)(4).

[159] Paula's may also argue that the merger clause in the Franchise Agreement rendered Brown's reliance on the statements in the disclosure document unreasonable. *See, e.g.*, Cottman Transmission Sys., L.L.C. v. Kershner, 536 F. Supp. 2d 543, 551-55 (E.D. Pa. 2008), discussed *infra* note 208. The court should reject this argument on the basis that the merger clause is illegal to the extent that it operates to disclaim any of the contents of the disclosure document. *See infra* notes 349-55 and accompanying text.

[160] Barkoff, *supra* note 43, at 236 n.15. As Barkoff observes, the court may also require that fraud be pleaded with a high degree of particularity. In general, he writes, "fraud lawsuits are not favored by the courts, and generally fraud is difficult to prove." *Id.* at 236.

[161] 570 So.2d 661 (Ala. 1990).

[162] The court's account of the facts does not state that the franchisor mentioned the sales of the operating stores. *See id.* at 663-64.

> Commission. I charge you that you may consider those regulations in determining what duty, if any, the defendants owed the plaintiffs to disclose [their] earnings relative to the operation of [their] business.[163]

The jury returned a verdict for the franchisee.[164]

The duty to disclose was relevant because the franchisor could argue that although it had made predictions that turned out to be erroneous, it had not mentioned the sales of its existing stores. Unless it had a duty to disclose those sales, it had made no misrepresentation.[165]

The Alabama Supreme Court upheld the instruction. The court drew an analogy to cases in which juries are permitted to consider government safety regulations in determining negligence.[166] Although the court did not use the phrase "negligence per se," its decision had much the same effect as decisions applying the negligence per se doctrine. Just as that doctrine permits plaintiffs to use evidence of a statutory or regulatory violation as evidence of negligence, the court's decision permitted the franchisee to use evidence of the FTC Rule as evidence of misrepresentation. If the court in Brown's case reasons the same way,[167]

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[163] *Id.* at 665.

[164] There was no need to prove scienter; a section of the state's code defines fraud inclusively as a "misrepresentation[] of a material fact made willfully to deceive, or recklessly without knowledge, and acted on by the opposite party, or if made by mistake and innocently and acted on by the opposite party . . . ." ALA. CODE § 6-5-101 (LexisNexis 2005).

[165] *See generally* 2 DOBBS, *supra* note 24, § 481.

[166] *Rodopoulos*, 570 So.2d at 665. For discussion of the generally similar concept of negligence per se, see *supra* notes 83-109 and accompanying text.

[167] At least one other court has done so. In *TC Tech Management Co. v. Geeks on Call America, Inc.*, No. 2:03-CV-714-RAJ, 2004 WL 5154906 (E.D. Va. Mar. 24, 2004), a federal district court followed *Rodopoulos*, holding that a franchisee that claimed to have been defrauded could use its franchisor's alleged violation of the FTC Rule to "help establish that [the franchisor] violated a duty to disclose information to [the franchisee]." *Id.* at *5. The franchisor argued that the court should dismiss the fraud claim because there is no private action under the Rule. The franchisee responded that it was merely "using the [Rule] to prove an element of a concealment fraud claim," *id.*, a response that the court found to be viable under Virginia law, which applied to the dispute. The court grouped *Rodopoulos* with cases upholding claims of negligence per se on the basis of federal regulations:

> The Court finds that [the franchisee] can use [the franchisor's] alleged violation of a federal regulation to help establish that [the franchisor] violated a duty to disclose information to [the franchisee]. Several courts have held that FTC regulations can be used to establish a duty of care for fraud and negligence claims. For example, in *Florida Auto Auction of Orlando, Inc. v. U.S.*, the United States [sic] Court of Appeals for the Fourth Circuit specifically rejected the defendant's argument that a breach of duty

the fact finder's consideration of the Rule will probably enhance her chances for recovery.

b. Tort Law Generally

In general, absent a controlling statute or regulation, the court may believe that any recovery for Brown should be in contract rather than tort. Dobbs describes a rule that the court may follow or adopt: "Subject to some qualifications, the contractual economic loss rule holds that contracting parties cannot sue one another in tort for pure economic harms on matters covered by the contract. Instead, they may obtain relief according to the contract terms and subject to the rules of law applied to contract."[168] The rule arguably "honors the parties' agreement by limiting liability on contract matters to those liabilities the contract itself contemplates and subject to the limitations imposed by law upon contract liabilities."[169] Brown was under no disability when she negotiated for the purchase of her franchise, and she should arguably have been more vigilant in protecting her own interests. Her injury was economic rather than personal, and the court may reason that the company's conduct was not sufficiently blameworthy to justify tort liability.

2. Contract Law, Excluding Warranty Law

Brown will be able to muster some arguments under the common law of contract even if she does not invoke warranty law. Contract law is

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> imposed by federal regulations cannot give rise to [sic] state law claim of negligence. 74 F.3d 498, 502 n.2 (4th Cir. 1996); *see also In re Sabin Oral Polio Vaccine Prods. Litig.*, 984 F.2d 124, 127-28 (4th Cir. 1993) (per curiam) (affirming the district court's holding that defendant's violation of federal oral polio vaccine regulations gives rise to Plaintiff's claims of negligence *per se* liability under state law). Also, in *Rodopoulos v. Sam Piki Enterprises, Inc.*, 570 So.2d 661, 665 (Ala. 1990), the Alabama State Supreme Court upheld the trial court's decision to submit to the jury FTC regulations as evidence of concealment fraud. In rendering its decision, the court found that FTC regulations are admissible in this fraud case with regard to the defendants' duty to disclose." *Id.* Therefore, following the precedent and reasoning provided by prior decisions, [the franchisor's] motion to dismiss for alleged private action under [the Rule] is DENIED.

Id. See also Holland et al., *supra* note 24, at 18-19.

[168] 2 DOBBS, *supra* note 24, § 482A, at 306-07 (Supp. 2008) (footnote omitted).

[169] *Id.* at 307. *See also* Holland et al., *supra* note 24, at 53 ("In the disclosure context, the Economic Loss Rule should bar a tort claim alleging that the franchisor fraudulently induced the franchisee by representing that the franchisor would fulfill its obligations under the agreement.").

designed to protect expectations,[170] and Paula's created an expectation that Brown would receive expert site selection assistance. Because she did not, she is arguably entitled to expectation damages.[171] On the whole, however, the prospects for a recovery are not bright.

Brown may seek to persuade the court to enforce Paula's affirmation of site selection expertise as part of a contract. If she does, however, the company will respond that in general, non-warranty contract law enforces promises, as opposed to affirmations.[172] The court is unlikely to try to shoehorn the affirmation into the Restatement (Second) of Contracts's definition of a promise: "a manifestation of intention to act or refrain from acting in a specified way, so made as to justify a promisee in understanding that a commitment has been made." [173] As a result, contract enforcement of the affirmation is highly unlikely.

Brown will argue next that the company's promise of expert site selection assistance is enforceable in contract. Her argument would have been straightforward and very likely successful if the promise had been set forth in the Franchise Agreement.[174] Because the Franchise Agreement said nothing about site selection, however, she will need to make one of two arguments. Either the promise was part of a freestanding contract for site selection assistance, or it was part of the Franchise Contract[175] despite its absence from the Franchise Agreement.

a. Separate Contract

The argument over whether the parties made a separate contract for site selection services is relatively straightforward, and Paula's may well prevail for two reasons. First, the company's promise was part of its disclosure document, which did not purport to be a contract, and second Brown arguably gave no consideration for the promise.

The disclosure document consisted largely of descriptive material regarding Paula's and its existing and former franchisees, as well as various parameters within which the company and a prospective franchisee might negotiate a franchise agreement. The document did not consist of a set of

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[170] *See, e.g.*, JOSEPH M. PERILLO, CALAMARI & PERILLO ON CONTRACTS §14.4 (5th ed. 2003) (stating general rule of expectation damages for breach of contract).

[171] *Id.*

[172] The affirmation is likely to be actionable in contract only under the rubric of warranty law, which incorporates affirmations concerning quality in contracts. *See infra* text at note 239.

[173] RESTATEMENT (SECOND) OF CONTRACTS § 2 (1979).

[174] A franchisee was able to enforce a promise of site selection assistance in *TCBY Sys., Inc. v. RSP Co, Inc.*, 33 F.3d 925 (8th Cir. 1994). The promise appeared in the parties' franchise agreement: "[the franchisee] signed a franchise agreement, which stated that [the franchisor] would provide reasonable assistance in selecting and evaluating proposed store locations, but [the franchisor's] selection of a proposed location was not a warranty or representation of the location's suitability." *Id.* at 927.

[175] *See supra* note 23.

commitments that the company and Brown had made to each other. The fact that it incorporated a copy of the company's standard franchise agreement[176] highlights the contrast between its language of disclosure and the language of commitment that pervades written contracts. Indeed, many prospective franchisees who receive copies of disclosure documents decide not to buy franchises.[177]

On the issue of consideration, Paula's can observe that Brown gave the company nothing in exchange for its promise.[178] In some important respects, the case resembles *Brennan v. Carvel Corp.*,[179] in which the First Circuit upheld a trial court's finding of a separate contract for site selection services. Yet Paula's can argue persuasively that *Brennan* is distinguishable.

Like Paula's, Carvel advertised expert site selection personnel and included in its franchise offering circular[180] a provision concerning site selection:

> Carvel will assume responsibility for selecting, obtaining and negotiating a suitable location for the Carvel Store. When a location has been approved, Carvel will negotiate a

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[176] In this Paper, whereas the term "Franchise Agreement" refers to the document that Brown and Paula's executed to memorialize the sale of her franchise, and the term "Franchise Contract" refers to the resulting legal relations between Brown and Paula's, see *supra* note 23, the term "franchise agreement" refers to a document executed by any other franchisee and franchisor to memorialize their purchase and sale of a franchise, and the term "franchise contract" refers to the resulting legal relations between the other franchisee and franchisor. *See id.*

[177] *But see* Arnold, *supra* note 43, at 212. Arnold writes:

> Franchisors often are not eager to provide disclosure documents to parties before they have expressed a serious interest in the franchise system. Under the [FTC Rule], a franchisor may be able to carry on extensive discussions with a prospective franchisee and require a significant amount of information from the prospective franchisee so long as the required disclosures are made "at least 14 calendar-days before the prospective franchisee signs a binding agreement with, or makes any payment to, the franchisor or an affiliate in connection with the proposed franchise sale."

Id. (footnote omitted) (quoting 16 C.F.R. § 436.2(a) (2008)).

[178] *See* RESTATEMENT (SECOND) OF CONTRACTS § 71 (1979) (defining consideration for a promise as a promise or performance given in exchange for the promise).

[179] 929 F.2d 801 (1st Cir. 1991).

[180] At the time when the events in *Brennan* occurred, many franchisors provided disclosure to prospective franchisees by means of Uniform Franchise Offering Circulars. *See* Judith M. Bailey & Dennis E. Wieczorek, *Franchise Disclosure Issues*, *in* FUNDAMENTALS OF FRANCHISING 93, 101 (Rupert M. Barkoff & Andrew C. Selden, eds. 2004) ("[T]he overwhelming majority of franchisors choose to prepare disclosure documents pursuant to the UFOC Guidelines . . . .").

> rental arrangement, prepare and approve lease documents, and handle the closing and signing of the lease. A one time real estate fee of $2,500.00 is paid by the [franchisee].[181]

A Carvel employee who lacked experience in site selection in the state approved an unsuitable site, and the Brennans bought a franchise for a store at the site. Like Brown, they sued to recover for losses sustained because of the site's unsuitability. Unlike Brown, however, they had entered into a "deposit agreement" with Carvel before executing a franchise agreement, and they had paid a $1,000 deposit. The deposit agreement provided in part:

> In consideration of the services to be rendered to the [Brennans] hereunder, the [Brennans] agree[] not to disclose or to make use of . . . any trade secrets or information disclosed to [the Brennans] in reliance upon this application, including, but not limited to, contemplated locations for Carvel Stores, methods of financing, sources of supply, merchandising techniques and operating methods. It is intended that this clause shall be effective whether or not a Carvel [franchise agreement] is entered into between the parties.[182]

At the closing of the sale of the franchise, the parties also executed "several Carvel sales contracts."[183] Pursuant to one of those contracts, the Brennans paid a $2,500 "real estate services fee."[184] None of the documents described the real estate services they received.

The First Circuit concluded that the trial court's finding of a separate contract for site selection assistance was not clearly erroneous:

> That the deposit agreement entered into by the Brennans and Carvel, and Carvel's promise to select, evaluate, and approve a suitable site for the Brennan's ice cream store constituted a separate contract, or an agreement collateral to the franchise agreement, may be shown by an examination of the deposit agreement. The deposit agreement expressly stated that Carvel would expend "a substantial amount of time and effort" in seeking a suitable

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[181] *Brennan*, 929 F.2d at 804.
[182] *Id.*
[183] *Id.* at 805.
[184] *Id.* The opinion does not state that the Brennans paid the fee, but it implies as much by stating that they "were charged" the fee. *Id.* at 808. Moreover, the court referred to the fee in finding that there was consideration for Carvel's promise to provide real estate services. *Id.*

> location for the Brennans' ice cream store. The deposit agreement also required that the Brennans not disclose any trade secrets or information regarding potential sites received during this process.
>
> Furthermore, evidence that the Brennans and Carvel intended to form a separate contract requiring Carvel to select, evaluate and approve a suitable site or location for the Brennans' ice cream store may be found from other materials. For example, Carvel's informational brochure, which was given to the Brennans at their first meeting with a Carvel representative and prior to the formation of the deposit agreement, stated that Carvel employed "Real Estate location experts," who were "dedicated to help its owner-operators succeed in their stores." The disclosure statement specifically stated that Carvel would "assume responsibility for selecting, obtaining and negotiating a suitable location for the Carvel Store." In addition, the sales contract assessed against the Brennans a $2,500 fee for real estate services, but did not describe the services provided.[185]

The First Circuit's conclusion concerning the deposit agreement was clearly correct insofar as consideration is concerned. In exchange for its promise of site selection services, Carvel sought the Brennans' promise to keep information confidential. Moreover, the Brennans gave their promise in exchange for Carvel's.[186] The $2,500 fee also supports the court's conclusion.

In Brown's case, however, there was neither a deposit agreement nor a sales contract. Unlike the Brennans, moreover, she paid neither a deposit nor a real estate fee. She may argue that the consideration for Paula's site selection promise was her continued participation in negotiations with the company. The court may agree, reasoning that the parties did not regard the site selection services as a gift from the company to her. Yet no documents recognized an exchange relationship between the services and her participation, and she did not promise to continue to negotiate.

The conclusion that there was no consideration for Paula's site selection promise would not necessarily mean that there was no separate contract. If the court viewed Brown's reliance on the promise as reasonable, she might have a cause of action under section 90 of the

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[185] *Id.* at 807-08.

[186] *See* RESTATEMENT (SECOND) OF CONTRACTS § 71 (1979).

Restatement (Second) of Contracts, under which reliance can effectively substitute for consideration.[187]

If the court does find a freestanding contract for site selection services, the company may argue that the parties discharged that contract by executing the Franchise Agreement,[188] which contained a merger clause. Brown can respond, however, that even if the Franchise Agreement was a complete integration of the Franchise Contract,[189] the subject of the integration was the sale of the franchise, and not site selection.[190] The court so held in *Brennan*, permitting the franchisees to introduce evidence of Carvel's site selection promise despite a merger clause in the parties' franchise agreement.[191]

b. No Separate Contract

If there was no separate site selection contract, Brown will make an argument in two steps. First, the site selection promise was one of the terms on which she and Paula's agreed as a term of the franchise sale. And second, the parties did not discharge that promise by executing the Franchise Agreement. The second step will require Brown to refute Paula's arguments concerning the parol evidence rule.

i. Agreement on the Site Selection Promise

The parties could have agreed on the site selection promise in one of two ways.[192] First, there could have been helpful language in the

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[187] RESTATEMENT (SECOND) OF CONTRACTS §§ 17(2), 90 (1979).

[188] *See supra* text at note 23.

[189] *See infra* text at note 208.

[190] *See* PERILLO, *supra* note 170, § 3.4(b) ("[T]he existence of a total integration [does] not prevent 'collateral contracts'—those that are independent of the writing—from being introduced so long as the main agreement [is] not contradicted." (footnote omitted)).

[191] *See* Brennan v. Carvel Corp., 929 F.2d 801, 806-09 (1991).

[192] These methods of incorporation are both based on assent. Brown might argue that there is a third method, not based on assent, of incorporation of a term that would let her recover for breach of contract. Consider the following excerpt from Joseph Perillo's treatise:

> It is often stated that existing rules of law are incorporated into contracts. This is often an elliptical way of stating that the Constitution protects the validity of contracts under the Contract and Due Process clauses, or that the common law does not favor retroactive termination of vested rights by legislative or administrative action. However, the statement is not so limited. Mandatory provisions of law governing the kind of contract in question are read into the contract.

PERILLO, *supra* note 170, § 3.13 (footnotes omitted). If the FTC Rule is incorporated in her Franchise Contract, Brown can argue that Paula's violation of the Rule was a breach of that contract. This argument raises at least three problems, however. First, the alleged breach occurred before the formation of the Franchise Contract. Absent an express or implied promise by Paula's that it had not violated the Rule—a warranty—it is unclear

Franchise Agreement. That language could have incorporated by reference either the entire disclosure document or at least those provisions relating to site selection, or it could have constituted or implied a promise by Paula's to stand behind the contents of the disclosure document. Second, by giving Brown the disclosure document, Paula's could have promised to include expert site selection services in the package that Brown would purchase, and that promise could have become a term of the franchise sale without the aid of any language in the Franchise Agreement.

(A) Helpful Language in the Franchise Agreement

In her search for helpful language in the Franchise Agreement, the best Brown is likely to find is a provision in which Paula's acknowledges having given her disclosure, such as the following paragraph from a McDonald's franchise agreement:

> Neither McDonald's nor anyone acting on its behalf has made any representations, inducements, promises, or agreements, orally or otherwise, respecting the subject matter of this Franchise, which is not embodied herein or set forth in the [disclosure document which McDonald's furnished to the franchisee] . . . .[193]

If the Franchise Agreement contains comparable language, the court will probably conclude that an acknowledgment of disclosure is by no means the same as language incorporating the disclosure document or any of its

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how the company's earlier action could have constituted a breach. Second, the FTC Rule arguably governs the process of franchise contract formation, as opposed to the terms of franchise contracts. Third, the rule that contracts incorporate all existing laws is less than absolute:

> Contrary to petitioners' suggestion, we have not held that all state regulations are implied terms of every contract entered into while they are effective, especially when the regulations themselves cannot fairly be interpreted to require such incorporation. For the most part, state laws are implied into private contracts regardless of the assent of the parties only when those laws affect the validity, construction, and enforcement of contracts.

Gen. Motors Corp. v. Romein, 503 U.S. 181, 189 (1992). *See also, e.g.*, U.S. v. Vandenbergen, 969 F.2d 338, 340 (7th Cir. 1992) (observing that *Romein*, "among many other cases, shows that incorporation of public law into private contract is not taken to its limit"); Robert A. Graham, Note, *The Constitution, the Legislature, and Unfair Surprise: Toward a Reliance-Based Approach to the Contract Clause*, 92 MICH. L. REV. 398, 428 n.171 (1993) ("[L]egal rules are only implied terms for the purpose of making the contract something more than an unenforceable promise").

[193] McDonald's Franchise Agreement, attached as Exhibit A to McDonald's Franchise Offering Circular issued May 1, 2005, at 28(i).

provisions in the Franchise Agreement.[194] Brown's case resembles *Rock v. Voshell*,[195] in which a home buyer claimed that she had received a misleading disclosure statement from her seller. Alleging that she had bought the home in reliance on the statement, the buyer sued, arguing *inter alia* that the statement had been incorporated in the sales agreement. She pointed to a checkmark in the agreement that appeared next to the following provision: "Buyer has received a Seller's Property Disclosure Statement before signing this agreement."[196] Not surprisingly, the court rejected the buyer's argument: the checkmark signified her "receipt of that [s]tatement and nothing more."[197]

Moreover, Brown cannot argue persuasively that the acknowledgment constitutes or even implies a promise by Paula's to stand

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[194] *See, e.g.*, Davis v. McDonald's Corp., 44 F.Supp.2d 1251, 1257 (N.D. Fla. 1998) ("To incorporate another document by reference, the contract must show an intent to incorporate that other document and make it part of the contract." (quoting Payne v. McDonald's, 957 F. Supp. 749, 756 (D. Md. 1997)). *But see* Gen. Retail Serv., Inc. v. Wireless Toyz Franchise, L.L.C., 255 F. App'x. 775, 791-92 (5th Cir. 2007). In *General Retail*, a franchisee claimed that the franchisor's offering circular contained misleading statements. The franchisee alleged several causes of action, including misrepresentation and violation of the applicable Little FTC Act. The federal district court hearing the case granted summary judgment for the franchisor on the misrepresentation claims, relying at least in part on a merger clause in the franchise agreement. In the words of the district court, "statements and representations not incorporated in the Franchise Agreement are nothing more than 'puffing' or sales talk . . . ." *Id.* at 791-92. The Fifth Circuit quoted a paragraph from the parties' franchise agreement:

> *Except as provided in the Offering Circular* delivered to the [franchisee], the [franchisee] acknowledges that Wireless Toyz has not, either orally or in writing, represented estimated or projected any *specified level of sales, cost or profits for this Franchise*, nor represented the sales, cost or profit level of any other Wireless Toyz Store.

Id. at 791. The franchise agreement also provided that the franchisee warranted that, "based on the information disclosed in the Offering Circular . . . [the franchisee] was financially able to accept the risks associated with [the franchise]." *Id.* Concluding that the district court had erred in various respects, the Fifth Circuit reversed and remanded. On remand, the Fifth Circuit wrote, "[i]n light of [the merger clause and the quoted paragraph, the district court] should consider whether statements in the Offering Circular are incorporated into the Franchise Agreement." *Id.* at 792. On remand, the franchisee could argue that, by including its warranty in the franchise agreement, the franchisor had implicitly vouched for the accuracy of the information in the Offering Circular that formed the basis of that warranty. For a case in which a contract for the sale of real estate incorporated by reference written warranties set forth in other documents, see *Flom v. Stahly*, 569 N.W.2d 135, 138, 140 (Iowa 1997).

[195] 397 F. Supp. 2d 616 (E.D. Pa. 2005).

[196] *Id.* at 620.

[197] *Id.* at 623.

behind the contents of the disclosure document.[198] Consider the following provision from the McDonald's franchise agreement quoted above:

> The parties agree that the happening of any of the following events shall constitute a material breach of this Franchise and violate the essence of Franchisee's obligations and, without prejudice to any of its other rights or remedies at law or in equity, McDonald's, at its election, may terminate this Franchise upon the happening of any of the following events:
>
> . . .
>
> (n) Franchisee makes any misrepresentations to McDonald's relating to the acquisition and/or ownership of this Franchise;
>
> . . . .[199]

The clear implication of that language is that the franchisee not made any misrepresentations to McDonald's. There is no comparable provision in the agreement concerning any misrepresentations by McDonald's to the franchisee.

If Brown's Franchise Agreement provides that she has not made any misrepresentations in acquiring her franchise, but contains no comparable provision relating to misrepresentations by Paula's, the court will probably reason that she and the company knew how to draft language providing that a misrepresentation constituted a breach of contract and chose to do so only with respect to a misrepresentation by her. Even absent such a material breach provision, moreover, a plain-meaning interpretation of the acknowledgment language will not lead to the conclusion that it amounts to a promise by Paula's to stand behind any of the contents of the document.[200]

(B) No Helpful Language in the Franchise Agreement

Lacking helpful language in the Franchise Agreement, Brown will argue that the court's starting point should be Joseph Perillo's observation that, in determining the terms of a contract, "[a]ll of the writings that form a

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[198] For an example of language from a franchise agreement that arguably implies a promise by the franchisor to stand behind some of the information in a disclosure document, see *Gen. Retail Serv., Inc. v. Wireless Toyz Franchise, L.L.C.*, 255 F. App'x. 775, 791 (5th Cir. 2007). For a brief summary of the case, see *supra* note 194.

[199] McDonald's Franchise Agreement, attached as Exhibit A to McDonald's Franchise Offering Circular issued May 1, 2005, at 18, 18(n).

[200] *See, e.g.*, Davis v. McDonald's Corp., 44 F. Supp. 2d 1251, 1257 (N.D. Fla. 1998).

part of the same transaction should be interpreted together and, if possible, harmonized."[201] The disclosure document and the Franchise Agreement were both part of one transaction: her purchase of the franchise. The court can harmonize the two documents because there is no inconsistency between them; nothing in the Franchise Agreement,[202] except perhaps the merger clause, contradicts the promise of expert site selection that appeared in the disclosure document. The court should therefore find that the parties included the promise as a term of the franchise sale.

Paula's will respond, however, that the disclosure document does not purport to be and is not a manifestation of the parties' assent.[203] Moreover, by the time Brown and Paula's executed the Franchise Agreement, site selection had already taken place. Even apart from any discharge of the site selection promise under the parol evidence rule, then, a court might very well find that the parties did not intend to include the promise as a term of the franchise sale.

On the whole, the resolution of this issue is likely to depend on the court's overall approach to issues of contract formation and interpretation. A court that tends to focus on documents to the exclusion of other evidence, and to interpret those documents literally, may conclude that the promise was not a term of the franchise sale. A court that is less inclined to focus on documents alone and to interpret them literally may conclude that, at least initially, the promise in the disclosure document was a term of the franchise sale.[204]

ii. Parol Evidence

If the court concludes that the parties initially agreed on the company's promise concerning site selection assistance, the analysis will move to the parol evidence rule. Analysis under that rule is necessary because the parties might have discharged the promise by executing the Franchise Agreement. If so, the promise was no longer binding on Paula's in the wake of Brown's purchase of her franchise; it was not part of the Franchise Contract.

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[201] PERILLO, *supra* note 170, § 3.13. Perillo rejects the standard distinction between "offering evidence of a consistent additional term and offering evidence on the issue of meaning." *Id.* § 3.16. As a result, he would presumably not limit the reach of the generalization in the text to questions of interpretation of the words of a written contract. Allan Farnsworth, by contrast, includes a generalization similar to Perillo's in a subchapter on interpretation of contractual language, while another subchapter discusses determination of "the subject matter to be interpreted." *See* E. ALLAN FARNSWORTH, CONTRACTS, ch. 7 (4th ed. 2004). Farnsworth's generalization appears in subchapter 7(C), on interpretation. *See id.* § 7.10, at 453. Subchapter (B) discusses the determination of the subject matter to be interpreted. *Id.* subch. (B).

[202] Recall that the Franchise Agreement said nothing about site selection or site selection assistance. *See supra* text at note 23.

[203] *See supra* text at notes 176-77.

[204] *See, e.g.*, Robert A. Hillman, *The "New Conservatism" in Contract Law and the Process of Legal Change*, 40 B.C. L. REV. 879 (1999).

The issue under the parol evidence rule will be whether the Franchise Agreement was a complete integration of the parties' agreement for the franchise sale.[205] The court will very likely believe that the Franchise Agreement is at least a partial integration of that agreement. It is a formal document which the parties signed at the conclusion of their negotiations, and it certainly appeared final at least with respect to the terms that it contained.[206]

If the Franchise Agreement is only a partial integration, Brown's evidence of Paula's site selection promise will probably be admissible. The evidence does not contradict any language in the Franchise Agreement, which says nothing about either site selection or site selection assistance.[207] In that case, Brown may well prevail.

If the Franchise Agreement is a complete integration, however, then by signing it Brown and Paula's discharged all their earlier promises, including the site selection promise. Unless Brown is able to use the FTC Rule to defeat the parol evidence rule, her evidence of the promise will be inadmissible and she will lose.[208]

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[205] Recall that the Franchise Agreement is the document Brown and Paula's executed to memorialize their agreement regarding the sale of the franchise and the Franchise Contract is the resulting set of legal relations. *See supra* note 23.

[206] *See* FARNSWORTH, *supra* note 201, § 7.3, at 418-19 ("If [parties to a written contract] intended the writing to be a final expression of the terms it contains, but not a complete expression of all the terms agreed upon — some terms remaining unwritten — the agreement is partially integrated.").

[207] *See id.* at 420 ("If an agreement is only partially integrated, it must then be determined whether the evidence of prior negotiations sought to be introduced would be 'consistent' with the writing and would therefore merely 'supplement' it, or whether it would 'contradict' a term of the writing. In the former case it is admissible but in the latter it is not." (footnotes omitted)).

[208] For discussion of the FTC Rule's provisions concerning parol evidence, see *infra* notes 348-64 and accompanying text. In *Cottman Transmission Systems, L.L.C. v. Kershner*, 536 F. Supp. 2d 543 (E.D. Pa. 2008), franchisees alleged various causes of action against their franchisor, including common law fraud in the inducement and negligent misrepresentation. They alleged that the franchisor's offering circular (UFOC) had contained misleading information which led them to invest in the franchise system:

> For example, the Franchisees allege that [the franchisor] misrepresented the average profit made by franchise store owners, the number of . . . franchise stores that had closed in the past, the experience necessary to operate a franchise, and the average sales of franchise stores. The allegation is not that [the franchisor] made fraudulent promises or projections of the earnings of future franchisees, but that [the franchisor] inaccurately reported the data for past time periods, distorting the facts upon which the Franchisees based their decisions of whether to purchase . . . franchise stores.

Id. at 552. The franchisees had signed franchise agreements that contained merger clauses, and those clauses stated that the franchisees were not relying on any

As James Thayer famously observed, few subjects are harder to understand than the parol evidence rule.[209] There is clearly more than one judicial methodology[210] for determining the extent of an integration, and leading commentators have adopted different classifications of the existing methodologies.[211] Allan Farnsworth also reports that "[s]urprisingly little light is shed on the problem by the hundreds of decisions resolving the issue of whether an agreement is completely integrated."[212]

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representations not incorporated in the franchise agreements. Applying Pennsylvania law, the court dismissed the claims of fraud and negligent misrepresentation. *Id.* at 554. "The parol evidence rule," the court wrote, "prevents the Franchisees from relying on extrinsic evidence, including the UFOC, to establish their claims of fraud in the inducement or negligent misrepresentation." *Id.* at 552.

Some state courts maintain an exception to the parol evidence rule for evidence offered to establish fraud in the inducement of a contract. *See, e.g.*, PERILLO, *supra* note 170, § 3.7(c) ("The general rule is that a proof of fraud in the inducement may be shown to avoid the written agreement even in the face of a merger clause and even if the evidence offered specifically contradicts the writing or a merger clause." (footnotes omitted)). The rationale for these holdings is that, in Perillo's concise phrase "[f]raud corrupts everything it touches." *Id.* A merger clause in a contract induced by fraud should therefore be ineffective.

If a court holds, as did the *Cottman* court, that the parol evidence rule excludes evidence of the contents of a disclosure document when those contents are offered to establish misrepresentation, then a fortiori that court should exclude evidence of those contents when offered to establish terms of a contract in the absence of proof of misrepresentation.

See also Medicine Shoppe Int'l v. Stopa, No. 4:07-CV-642, 2008 U.S. Dist. LEXIS 62427, at *10 (E.D. Mo. Aug. 11, 2008) ("To the extent that the parties believe that the UFOC and Operations Manual are part of the License Agreement, that position would appear to be foreclosed by the agreement's merger or integration provision.").

[209] "Few things in our law are darker than this, or fuller of subtle difficulties." James B. Thayer, *The "Parol Evidence Rule,"* 6 HARV. L. REV. 325, 325 (1893). Writing before the advent of either the Code or its predecessor, the Uniform Sales Act, Thayer referred to the common law parol evidence rule.

[210] The issue of whether the parol evidence rule excludes evidence is one for the court. Perillo explains:

> The parol evidence rule is generally stated in terms of the intent of the parties. Did the parties intend an integration and did they intend it to be total? Questions of intent are ordinarily questions of fact and would normally be submitted to a jury. However, the courts have transmuted this question of intent, whether actual or presumed, by legal alchemy into a question of law to be decided in the first instance by the trial judge and subject to appellate review.

PERILLO, *supra* note 170, § 3.2(c) (footnotes omitted).

[211] *Compare* PERILLO, *supra* note 170, § 3.4 (listing six methodologies in American law) *with* JOHN EDWARD MURRAY, JR., MURRAY ON CONTRACTS § 84(C) (4th ed. 2001) (also listing six methodologies in American law, but characterizing four of the six differently).

[212] FARNSWORTH, *supra* note 201, § 7.3, at 423 (footnote omitted).

In general, however, the relatively restrictive methodology of Samuel Williston and the more liberal methodology of Arthur Corbin have been highly influential.[213] Brown's evidence of Paula's promise is less likely to be admissible under Williston's methodology than under Corbin's.

(A) Williston

According to Williston, a court should determine whether a document is a total or only a partial integration by asking three questions.[214] Depending on the answer(s), the court may need to ask only the first, only the first two, or all three.

The first question is whether the document at issue—in this case the Franchise Agreement—contains a merger clause. If so, the document is a complete integration and there is no need to ask either the second or the third question.[215] Paula's will point out that the Franchise Agreement does contain a merger clause, which will render it a complete integration and exclude Brown's evidence. Because the Franchise Agreement says nothing about site selection or site selection assistance, Brown will have no cause of action for breach of contract.

If for some reason the court invalidates the merger clause,[216] the next question in Williston's analysis will be whether the Franchise Agreement appears complete.[217] Because one or more professional advisors probably drafted the document for Paula's, the answer is very likely yes. The analysis will therefore proceed to the third question.[218]

Williston's third question is whether Paula's promise concerning site selection assistance is one that the parties, in drafting the Franchise Agreement, would naturally have omitted. If they would naturally have omitted it from the document even though they regarded it as a term of the franchise sale, then the document is only a partial integration and the evidence is admissible. If they would not naturally have omitted the promise, the Franchise Agreement is a complete integration and the evidence is inadmissible.[219]

The "natural omission" test is objective. The issue is not what Brown and Paula's actually believed concerning the terms of the franchise

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[213] *See id.* at 422-23 (contrasting Williston's methodology with Corbin's); PERILLO, *supra* note 170, § 3.4 (same).

[214] This discussion of Williston's methodology is based on Perillo's summary of that methodology. *See* PERILLO, *supra* note 170, § 3.4(c).

[215] *See id.* The Franchise Agreement is probably not obviously incomplete and the merger clause was not "included as a result of fraud or mistake or any other reason sufficient to set aside a contract . . . ." *Id.*

[216] *See infra* notes 349-60 and accompanying text.

[217] PERILLO, *supra* note 170, § 3.4(c).

[218] If the Franchise Agreement had been obviously incomplete, it would have been at most a partial integration and Brown's evidence would probably have been admissible; the evidence is consistent with the document, which says nothing about site selection. *See id.*

[219] *Id.*

sale. Williston asks, rather, whether reasonable parties in the same circumstances would have omitted the promise from their franchise agreement even though they considered it part of the sale.[220]

The court's answer to the natural inclusion question is not easy to predict. Brown will of course argue that a reasonable franchisor and prospective franchisee could omit a site selection promise from their franchise agreement even though they considered it a term of the franchise sale. The omission would simply be the result of timing; the parties would assume when they signed the franchise agreement that the franchisor had already fulfilled its site selection promise. The prospective franchisee would certainly not have intended to release the franchisor from its promise, thereby losing any recourse if the site proved unsuitable. And without agreement by both parties, there could be no discharge.

Paula's will counter that a reasonable franchisor and prospective franchisee would not have signed a franchise agreement while believing that the promise was part of their franchise contract. In light of the importance to the prospective franchisee of proper site selection, his or her inexperience in selecting sites, and the fact that he or she was buying a franchise in a new location rather than taking over a going concern, he or she would have refused to sign the document unless the franchisor agreed to amend it to include the promise.

Given those opposing arguments and the degree of play in the parol evidence rule,[221] either Brown or Paula's may prevail on the integration issue. The result will probably depend on the court's approach to contract law in general and parol evidence questions in particular, its sense of the equities of Brown's case, and the case law of her jurisdiction.[222]

(B) Corbin

For Corbin, there is essentially only one question: did Brown and Paula's intend, by executing the Franchise Agreement, to discharge the site selection promise. The court must examine all the circumstances, as opposed to only the Franchise Agreement. The merger clause alone is not to have conclusive effect.[223] Although this question may seem to invite the same arguments as Williston's question regarding natural inclusion, the two questions are not the same. Corbin focuses on the actual intent of the two parties, as opposed to the presumed intent of a reasonable person. If Brown and Paula's, or either of them, signed the Franchise Agreement without intending to discharge the company's site selection promise, then there was no

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[220] *Id.*

[221] *See, e.g.*, PERILLO, *supra* note 170, § 3.2(b) (describing the parol evidence rule as "riddled through with exceptions and applications difficult to reconcile . . . .").

[222] For contrasting applications of the natural omission test, see *Mitchill v. Lath*, 160 N.E. 646 (N.Y. 1928) (majority and dissenting opinions).

[223] *See* 3 CORBIN, *supra* note 23, §§ 581, 582 (1960). *See also* PERILLO, *supra* note 170, § 3.4(d).

discharge. Only if both intended a discharge will Brown's evidence be inadmissible.[224] Although the court may believe that Paula's intended a discharge, it is unlikely to conclude that Brown did, so the result will likely be that the evidence is admissible.

C. Summary

The false affirmation and unperformed promise in Paula's disclosure document misled Brown. In reliance on the document, she bought a franchise in a location that was unsuitable, and she suffered serious losses as a result. If she sues in tort or in contract without claiming breach of warranty, she may or may not recover from the company. She is unlikely to be able to enforce its promise in tort. With respect to the false affirmation, a private action under the FTC Rule is probably out of the question. Moreover, her success will not be assured if she alleges one or more of the other four torts. Much will depend on her jurisdiction and the resolution of certain factual issues. She may, for example, fail in a common law fraud action if she is unable to prove that Paula's deceived her intentionally or negligently.

Although non-warranty contract law offers Brown some hope, the obstacles on that path are daunting. She has little hope of enforcing Paula's affirmation, and must focus instead on the company's site selection promise. Proving a freestanding contract for expert site selection assistance will be difficult. And enforcing the promise as part of the Franchise Contract will require her to prove both that the parties initially agreed on the promise as a term of the franchise sale and also that they did not discharge it by executing the Franchise Agreement.[225] She is not without arguments concerning the promise, but she would be unwise to assume that she will prevail.

III. A POSSIBLE SOLUTION: THE CODE, THE COMMON LAW, AND THE FTC RULE

If she can persuade the court to treat the contents of the disclosure document as express warranties, Brown will overcome at least some of the obstacles she faces in tort and in non-warranty contract law. Both

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[224] 3 CORBIN, *supra* note 23, §§ 581, 582.

[225] Paula's might also argue that, by executing the Franchise Agreement and beginning to operate the franchise, Brown waived any right she might have had to deny that the company had provided expert site selection services. A third possible argument for the company is that, having permitted it to rely on her apparent satisfaction with the services, she is estopped to claim that they were inadequate. Her response to either of those arguments should be that, until she tried and failed to make a profit in the operation of the franchise, she had no way of knowing that Swift was not an expert or that the site was inappropriate.

affirmations and promises can constitute warranties. Paula's affirmation, not otherwise enforceable in contract, will give rise to a promise to stand behind its truth. In addition, warranty law effectively draws certain affirmations and promises into a contract of sale even if non-warranty contract rules do not do so. As a result, Paula's affirmation and promise can be enforceable as express warranties even though they are not part of a freestanding contract for site selection assistance and even though they are neither included nor incorporated by reference in the Franchise Agreement. Moreover, warranty liability is strict liability. Brown will not need to prove that the company acted either intentionally or negligently in failing to provide expert site selection assistance.

If the affirmation and promise were warranties, Swift's inept performance was a breach of the Franchise Contract. Paula's will be liable to Brown for breach of contract and she will be entitled to expectation damages.[226]

Brown bought a business format franchise, and even if the Franchise Contract gave her the right to buy ingredients for soft ice cream from Paula's, the court will probably conclude that the common law governs her warranty claim.[227] Although courts have enforced express warranties in a variety of common law cases, however, few if any of those cases have involved sales of franchises. Brown must therefore persuade the court to extend the common law of express warranties into the arena of franchise sales.

Section 2-313 of the Code can play an important role in bringing about that extension. During the 1900s and earlier, legislatures and courts first developed warranty law to govern sales of goods and then extended various aspects of that law to other kinds of transactions.[228] The warranty

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[226] *See generally* RESTATEMENT (SECOND) OF CONTRACTS § 347 (1981) (normal remedy for breach of contract is expectation damages); U.C.C. § 2-714(2), (3) (measure of damages for breach of warranty is value of goods if they had been as warranted less their value as accepted plus, "[i]n a proper case," incidental and consequential damages). Brown will probably ask for compensation for the profits she would have made had she received expert assistance in selecting a site. The court will likely conclude that the profits are speculative because the business was new. *See* RESTATEMENT (SECOND) OF CONTRACTS § 352 (1981) ("Damages are not recoverable for loss beyond an amount that the evidence permits to be established with reasonable certainty."). The more likely measure of damages is the difference between the value the franchise would have had if the site selection assistance had been as promised and its actual value. The actual value was arguably zero because Brown was unable to make a profit. Of course, if Brown also holds the company liable in tort, the court will decline to award what it regards as a double recovery. For discussion of remedies for misrepresentation, see DOBBS *supra* note 24, § 483.

[227] *See supra* notes 6-11 and accompanying text.

[228] *See, e.g.*, 1 BARKELY CLARK & CHRISTOPHER SMITH, THE LAW OF PRODUCT WARRANTIES § 2:27 (2d ed. 2002) (describing the implied warranty of habitability in the sale of new homes as "an analogical extension of the [Code] implied warranty of merchantability . . . ."); Daniel E. Murray, *Under the Spreading Analogy of Article 2*

sections in the Code and its predecessor, the Uniform Sales Act,[229] functioned as blueprints; courts analogized other transactions to sales of goods for purposes of determining the seller's obligations concerning quality.[230] Brown's argument will be that the court should continue that process in her case.

To the extent that courts have already developed express warranty law for sales other than sales of goods, of course, the cases involving those sales will support Brown's argument. In a jurisdiction with a well-developed common law of express warranties, the step she asks the court to take will appear relatively small and the role of section 2-313 may be relatively minor. In a jurisdiction in which there is little common law precedent for enforcement of express warranties, her argument will appear more radical and the role of the section will be more important.

Under the Code,[231] as well as the common law,[232] the parol evidence rule can exclude evidence of affirmations and promises that would otherwise be enforceable as express warranties. As a result, Brown will invoke the new provision in the FTC Rule that is designed to prevent franchisors from using merger clauses to defeat claims based on statements in franchise disclosure documents. The new provision will probably permit her to introduce the evidence she needs to prove Paula's warranties.

Brown's argument will thus stand on three legs: the Code, the common law of express warranties, and the new FTC Rule provision.

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of the Uniform Commercial Code, 39 FORDHAM L. REV. 447, 456 (1971) (Courts that have found implied warranties in sales of new homes by builder-vendors "have justified these warranties by analogy to the implied warranties present in the sale of goods and have relied upon a series of law review articles advocating this growth from the sale of goods analogy." (footnote omitted)).

[229] UNIFORM SALES ACT (1906) (withdrawn 1951).

[230] *See, e.g.*, 3 RONALD A. ANDERSON, ANDERSON ON THE UNIFORM COMMERCIAL CODE § 2-314:74 (1995). Anderson reports:

> The fact that a given transaction is a non-Code transaction is not controlling in determining whether the Code should be applied. Courts following a . . . liberal approach to the interpretation of the Code look upon the Code's implied warranty provisions not only as provisions governing sales, but also as a statement of public policy embodying the foremost legal thought in commercial transactions.

Id. (footnotes omitted). *See also* Debra L. Goetz et al., Special Project, *Article 2 Warranties in Commercial Transactions: An Update*, 72 CORNELL L. REV. 1159, 1168-70 ("Courts use [an analogy] approach to extend Code warranties to nonsale transactions in goods." (footnote omitted)).

[231] *See* U.C.C. §§ 2-202, 2-316(1) (2002); 1 CLARK & SMITH, *supra* note 228, § 4:24, at 4-96 ("[O]ne of the most important applications of the parol evidence rule is to exclude oral (or prior written) express warranties.").

[232] *Id.* § 2:31 (In a sale of real estate, if an express "warranty is oral, the statute of frauds or the parol evidence rule could be raised as a barrier.").

Subpart A of this Part focuses on the Code, Subpart B on the common law, and Subpart C on the Rule.

Subpart A begins by demonstrating that, if section 2-313 applied to Brown's case, Paula's affirmation and promise would constitute express warranties, included in the Franchise Contract.[233] The Subpart then turns to policy considerations. The official commentary to section 2-313 reveals the principal policies on which it is based, and those policies militate in Brown's favor. Moreover, there is considerable support in Code literature, official commentary to Article 1, and case law for application of section 2-313 policies in particular and Code policies in general in non-Code cases. The Subpart concludes that the court should apply section 2-313 by analogy in Brown's case because its underlying policies are as apposite to sales of franchises as to sales of goods.

Subpart B samples the common law of express warranties in three kinds of sales that Brown can argue are analogous to hers: sales of real estate, services, and businesses. The sample suggests that there may be some useful cases in her jurisdiction and provides some insight into the influence of the Code and the Uniform Sales Act on the common law development. The sample also reveals the role of some other statutory provisions which may or may not be helpful to Brown, depending on the court's view of the implications of the legislature's action. The Subpart concludes that, although the impact of the statutes is uncertain, the common law cases may offer Brown helpful analogies.

Subpart C assesses the implications of the new FTC Rule provision regarding merger clauses for Brown's case. Under that provision, the merger clause in the Franchise Agreement is almost certainly unenforceable. In theory, a court following Williston's approach to the parol evidence rule could nevertheless find the Franchise Agreement to be a complete integration of the Franchise Contract. That outcome is unlikely, however, given the obvious purpose of the new provision. The more likely result is that Brown will prevail in the argument over parol evidence.

A. The Code

1. Application of Section 2-313 in Brown's Case

If section 2-313 applied to Brown's case, she would be able to base her claim of breach of express warranty on either Paula's affirmation or its promise, or both. The section provides as follows:

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[233] The assumption, of course, is that the parol evidence rule would not exclude evidence of either the affirmation or the promise. For discussion of the new FTC Rule provision that justifies that assumption, see *infra* notes 349-60 and accompanying text.

> **§ 2-313. Express Warranties by Affirmation, Promise, Description, Sample.**
>
> (1) Express warranties by the seller are created as follows:
>
> (a) Any affirmation of fact or promise made by the seller to the buyer which relates to the goods and becomes part of the basis of the bargain creates an express warranty that the goods shall conform to the affirmation or promise.
>
> (b) Any description of the goods which is made part of the basis of the bargain creates an express warranty that the goods shall conform to the description.
>
> (c) Any sample or model which is made part of the basis of the bargain creates an express warranty that the whole of the goods shall conform to the sample or model.
>
> (2) It is not necessary to the creation of an express warranty that the seller use formal words such as "warrant" or "guarantee" or that he have a specific intention to make a warranty, but an affirmation merely of the value of the goods or a statement purporting to be merely the seller's opinion or commendation of the goods does not create a warranty.[234]

Substituting "franchise" for "goods" leads to several conclusions in Brown's case. Consider first what the section does not say. It makes no reference to either scienter or negligence, so she need not prove either of those states of mind. Moreover, no language requires that express warranties be part of a freestanding contract or included or incorporated by reference in a written contract of sale. As a result, Brown need not prove compliance with either of those formalities. The official commentary[235] confirms that inference. Comment 3 provides in part:

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[234] U.C.C. § 2-313 (2002).

[235] White and Summers describe the Code comments as "by far the most useful aids to interpretation and construction." Judges "take to the comments like ducks to water, even though the legislatures did not enact the comments." WHITE & SUMMERS, *supra* note 9, § 5. The authors offer some caveats, however. *Id.* Moreover, other scholars have argued that the comments are not entitled to the same degree of deference as are the reporter's notes and illustrations in the Restatement (Second) of Contracts. *See* Peter A. Alces & David Frisch, *Commenting on "Purpose" in the Uniform Commercial Code*, 58 OHIO ST. L.J. 419 (1997).

> In actual practice affirmations of fact made by the seller about the goods during a bargain are regarded as part of the description of those goods; hence no particular reliance on such statements need be shown in order to weave them into the fabric of the agreement. Rather, any fact which is to take such affirmations, once made, out of the agreement requires clear affirmative proof. The issue normally is one of fact.[236]

Comment 7 adds: "The precise time when words of description or affirmation are made or samples are shown is not material. The sole question is whether the language or samples or models are fairly to be regarded as part of the contract."[237] Section 2-313 thus removes one of the major obstacles that confronted Brown under non-warranty contract law.[238]

Consider next what the section does say. Under subsection (1)(a), both Paula's affirmation of fact and its promise created express warranties

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[236] U.C.C. § 2-313 cmt. 3 (2002). Paula's can argue that the statements in the disclosure document were not made "during a bargain" but rather before the parties had begun to bargain. As a result, the statements should be included in the Franchise Contract only if Brown relied on them. Brown's response will be twofold. First, she received the document when she met with the sales manager for Paula's, and it was at that meeting that the parties' bargaining began. Second, even if the bargaining began after that meeting, she did rely on the statements so the court should treat them as part of the Franchise Contract.

[237] U.C.C. § 2-313 cmt. 7 (2002). *See also, e.g.*, U.C.C. § 2-714 cmt. 2 (2002) ("The 'non-conformity' referred to in subsection (1) includes not only breaches of warranties but also any failure of the seller to perform according to his obligations under the contract.").

[238] William Hawkland and Frederick Miller explain:

> The express warranty is merely a term of the contract having to do with the quality, description, or title of the goods, and it is not different in kind from other express terms such as price, delivery, or quantity. Much of the difficulty experienced by lawyers and courts with express warranties rests on an incomplete understanding of this basic proposition.
>
> The fact that an express warranty is simply a term of the contract does not, of course, mean that it must be separately bargained for, or even included in the written agreement. In the absence of limitations based upon the parol evidence rule, it is enough that the parties have actually agreed on the quality, description, or title of the goods.

William D. Hawkland & Frederick H. Miller, *Article 2: Sales* § 2-313:2, *in* HAWKLAND, U.C.C. SERIES (2002) (footnotes omitted).

if they related to the franchise[239] and became "part of the basis of the bargain." Moreover, the affirmation may have been part of the description of the franchise under subsection (1)(b), creating an express warranty under that subsection if it was part of the basis of the bargain.

Despite a large volume of scholarly commentary,[240] the courts have not reached a consensus concerning the meaning of the "basis of the bargain" requirement. Some courts have concluded that it requires the buyer to prove that he or she relied on the seller's statement(s), whereas other courts have found express warranties without proof of reliance.[241]

Paula's can argue with some force that the court should require proof of reliance in Brown's case. Reliance is necessary, the company will argue, to draw the affirmation and promise into the Franchise Contract. James White explains the logic that underlies this contention.[242] White notes that the historical roots of warranty law lie in tort as well as in contract.[243] Various writers have argued that the warranty cause of action grew out of the tort action for deceit, which required proof of reliance.[244]

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[239] Paula's might argue that the affirmation and promise related not to the franchise but rather to the site selection process. Brown can respond, however, that the site was for the franchise, and a suitable site is crucial to the success of a "bricks-and-mortar" store. The contents of the disclosure document all focused on Paula's franchises, and the language regarding site selection had no meaning except as applied to a franchise. The court will likely agree with Brown and find that the affirmation and promise did relate to the franchise for purposes of section 2-313.

[240] *See, e.g.*, WHITE & SUMMERS, *supra* note 9, § 9-5, at 356 (courts should require proof of reliance); Charles A. Heckman, *"Reliance" or "Common Honesty of Speech": The History and Interpretation of Section 2-313 of the Uniform Commercial Code*, 38 CASE W. RES. L. REV. 1 (1987) (courts should not require proof of reliance); Sidney Kwestel, *Freedom From Reliance: A Contract Approach to Express Warranty*, 26 SUFFOLK U.L. REV. 959 (1992) (same).

[241] WHITE & SUMMERS, *supra* note 9, § 9-5 n.2.

[242] *See* James J. White, *Freeing the Tortious Soul of Express Warranty Law*, 72 TUL. L. REV. 2089, 2109-10 (1998).

[243] *See id.* at 2090-94.

[244] *See id.* at 2091 ("'As has been seen, the action upon a warranty was in its origin a pure action of tort.'" (quoting SAMUEL WILLISTON, THE LAW GOVERNING SALES OF GOODS AT COMMON LAW AND UNDER THE UNIFORM SALES ACT 251 (1909) (footnote omitted))). *See also, e.g.*, 1 ORA FRED HARRIS, JR. & ALPHONSE M. SQUILLANTE, WARRANTY LAW IN TORT AND CONTRACT ACTIONS § 1.1 (1989). Harris and Squillante write:

> When one considers that the action for breach of warranty was one that originally was grounded in the tort of deceit but is now considered to be within the province of contract law, one can see that the statement "the seller's warranty is a curious hybrid, born of the illicit intercourse of tort and contract" is an accurate description both of the past and of the future development of the concept of warranty law.

Even today, White suggests, the basis of express warranty liability for false representations or broken promises that are not "part of the contract under conventional definitions of contract" is tort.[245] Just as reliance is necessary to establish liability for misrepresentation in tort, it should be necessary to draw pre-contractual affirmations and promises into the sales agreement, thereby giving the buyer a contract cause of action for their breach.[246]

Paula's will cite the chief obstacle that Brown encountered in non-warranty contract law: the statements in the disclosure document were not, in White's phrase, part of the Franchise Contract "under conventional definitions of contract." As a result, the court should grant warranty status to the statements only if Brown proves she relied on them.

In a jurisdiction in which the courts agree with the company's argument, Brown's ability to satisfy the basis of the bargain requirement will depend on her success in proving her reliance. In a jurisdiction in which the courts do not require reliance, however, Brown may recover for breach of warranty even if she could not have recovered for common law misrepresentation.[247]

If the court does require proof of reliance and Brown shows that she did rely on the statements, Paula's may argue that, given the merger clause in the Franchise Agreement, her reliance was unreasonable. The court should reject that argument on the basis of the new FTC Rule provision.[248]

Brown should have little, if any, difficulty in persuading the court that Paula's affirmation and promise were more than mere puffing under section 2-313(2). Although "expertise" is arguably a matter of degree, the affirmation and promise appeared in a legally required disclosure document on which prospective franchisees were supposed to be able to rely.

2. Policy

a. Express Warranties

A comment summarizes the principal policy that underlies section 2-313:

> In view of the principle that the whole purpose of the law of warranty is to determine what it is that the seller has in essence agreed to sell, the policy is adopted of those cases which refuse except in unusual circumstances to recognize a material deletion of the seller's obligation.

Id. (footnote omitted). *See also* Timothy J. Sullivan, *Innovation in the Law of Warranty: The Burden of Reform*, 32 HASTINGS L.J. 341, 351 (1980) ("Suits for breach of warranty were first brought in tort as actions on the case for deceit." (footnote omitted)).

[245] White, *supra* note 242, at 2109-10.

[246] *Id.*

[247] *See supra* notes 156-60 and accompanying text.

[248] *See infra* notes 349-60 and accompanying text.

> Thus, a contract is normally a contract for a sale of something describable and described. . . .
>
> This is not intended to mean that the parties, if they consciously desire, cannot make their own bargain as they wish. But in determining what they have agreed upon good faith is a factor and consideration should be given to the fact that the probability is small that a real price is intended to be exchanged for a pseudo-obligation.[249]

In the words of Karl Llewellyn, the principal drafter of Article 2, "'[w]hat we need in business is common honesty of speech,' telling the truth about commodities and standing ready to make good one's assertions."[250] Section 2-313(2) of course reflects the distinction between serious assurances, which merit enforcement, and mere sales talk, which does not.

The policy favoring common honesty of speech is at least as apposite—indeed as important—in the arena of franchise sales as in the arena of sales of goods. It is especially apposite, moreover, as applied to statements included in a legally mandated disclosure document. The FTC promulgated its Rule in response to considerable evidence of abusive sales tactics in franchising.[251] Many prospective franchisees are no doubt capable of protecting their own interests in negotiating with franchisors who eschew deceptive tactics. Yet the law should not expect even those prospective franchisees to question the veracity of the contents of a franchise disclosure document.

Common honesty of speech requires that the court hold Paula's to the contents of the disclosure document. The company chose to include the site selection affirmation and promise in the disclosure document it prepared, presumably to increase the attractiveness of its franchise offerings. Brown relied on the document, and her losses resulted from its misleading character. Even if Paula's acted neither intentionally nor negligently, it should bear the risk of inaccuracies in the document.

Paula's may argue that Brown would have discovered Swift's ineptitude if she had consulted existing or former Paula's franchisees. She might have discovered the unsuitability of the site if she had investigated

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[249] U.C.C. § 2-313 cmt. 4 (2002).

[250] UNIF. REVISED SALES ACT § 37 cmt. at 146 (Proposed Final Draft No. 1, 1944) (quoting Foote v. Wilson, 178 P. 430, 430 (1919)).

[251] *See* 2007 Statement of Basis and Purpose, *supra* note 32, at 15,445 ("The [FTC] promulgated the original franchise rule on December 21, 1978. Based upon the original rulemaking record, the [Agency] found widespread deception in the sale of franchises and business opportunities through both material misrepresentations and nondisclosure of material facts." (footnotes omitted)); *id.* at 15,447-49 (explaining the continuing need for the Rule).

the site's suitability herself, engaging any professional help she needed in the process. As a result, she is at least partly responsible for her losses.

Brown may not have had sufficient financial resources to obtain expert legal or business advice before making her purchase, however. And even if she had those resources and thus shares in the blame for her losses, the court can temper her remedy to reflect that fact. The Code entitles her to damages caused by the company's breach of warranty, and nothing more.[252]

b. Code Policies in Non-Code Cases

i. The Warranty Sections

The comments to section 2-313 reflect the Code's stance in favor of extra-textual application of the warranty sections on the basis of policy. Comment 2 provides:

> Although this section is limited in its scope and direct purpose to warranties made by the seller to the buyer as part of a contract for sale, the warranty sections of [Article 2] are not designed in any way to disturb those lines of case law growth which have recognized that warranties need not be confined either to sales contracts or to the direct parties to such a contract. They may arise in other appropriate circumstances such as in the case of bailments for hire, whether such bailment is itself the main contract or is merely a supplying of containers under a contract for the sale of their contents. The provisions of Section 2-318 on third party beneficiaries expressly recognize this case law development within one particular area. Beyond that, the matter is left to the case law with the intention that the policies of [the Code] may offer useful guidance in dealing with further cases as they arise.[253]

There is also support for that stance in case law[254] and Code literature.[255] Indeed, one author has suggested that an earnings claim made in

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[252] 4A ANDERSON, *supra* note 230, § 2:714:35 (1997 rev. of vol. 4) ("The fact that there is a breach of warranty does not in itself entitle the buyer to recover damages; the buyer must show what damages were proximately caused by the breach." (footnote omitted)).

[253] U.C.C. § 2-313 cmt. 2 (2002).

[254] *See* 1 HARRIS & SQUILLANTE, *supra* note 244, § 6.8 (1989) ("Application of the Code's language of express warranty to transactions outside the sale of goods is common in the case law. Although § 2-313 is phrased in Article 2 terminology, those courts which are willing to apply Code warranty law do so by analogy in these situations."); Johnson v. Healy, 405 A.2d 54 (Conn. 1978) (discussed *infra* notes 270-82 and accompanying text).

negotiations for the sale of a franchise could constitute an express warranty by description under section 2-313(1)(b).[256]

ii. The Code Generally

Article 1 consists of sections that apply throughout the remainder of the Code. Section 1-103 is entitled "Construction of [the Code] to Promote its Purposes and Policies; Applicability of Supplemental Principles of Law."[257] Subsection (a) calls on courts to engage in policy analysis: "[The Code] must be liberally construed and applied to promote its underlying purposes and policies."[258] Brown will argue that the notion of liberal application includes application to cases that arise outside the text of the Code. She will also cite subsection (b), which prescribes the relationship between the Code and the common law—a relationship in which common law rules supplement the Code except where its provisions displace them.[259] A comment to the section explains that displacement extends not only to those common law rules that are inconsistent with the Code's text but also to those that are inconsistent with its "purposes and policies."[260] Another comment emphasizes that courts can appropriately apply statutory policies even in cases that statutory text does not reach.[261]

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[255] *See* James O'Reilly, *An Eye for An Eye: Foresight on Remedies for LASIK Surgery's Problems*, 71 U. CIN. L. REV. 541, 551, 551 n.52 (2002) (Harm resulting from LASIK surgery may give rise to cause of action for breach of express warranty based on advertisements for the surgery; "[c]onceptually, eye surgery is a service rather than 'goods,' so the conventional treatment of express warranties under Uniform Commercial Code section 2-313 is available only by analogy."); A. Darby Dickerson, Note, *Bailor Beware: Limitations and Exclusions of Liability in Commercial Bailments*, 41 VAND. L. REV. 129, 165-66 (1988); Goetz et al., *supra* note 230, at 1168-70.

[256] Comment, *supra* note 9, at 1006-07.

[257] U.C.C. § 1-103 (2001).

[258] *Id.* § 1-103(a).

[259] *Id.* § 1-103(b). In general, Code sections displace otherwise applicable common law rules. *See* William D. Hawkland & Frederick H. Miller, *Revised Article 1: General Provisions* § 1-103:2 *in* 1 HAWKLAND UNIFORM COMMERCIAL CODE SERIES (2002) ("[T]he paramount rule of construction now is preemption."). For an example of a Code section that does not displace the common law rule on the same subject, see U.C.C. § 3-117 (2002).

[260] U.C.C. § 1-103 cmt. 2 (2001). *See also* Hawkland & Miller, *supra* note 259, § 1-103:2 ("[P]reemption extends to the displacement of any law that is inconsistent with the Code's express terms or its purposes and policies . . . .").

[261] The comment provides in part:

> Even prior to the enactment of the Uniform Commercial Code, courts were careful to keep broad acts from being hampered in their effects by later acts of limited scope. The courts have often recognized that the policies embodied in an act are applicable in reason to subject-matter that was not expressly included in the language of the act, and did the same where reason and policy so

With or without citation to these comments, courts have applied Code sections to non-Code transactions in many cases.[262] Consider the methodology of the Idaho Supreme Court:

> In order to determine which provisions are applicable, we will look to the commercial setting in which the problem arises and contrast the relevant common law with Article 2—we will use Article 2 as "a premise for reasoning only when the case involves the same considerations that gave rise to the Code provisions and an analogy is not rebutted by additional antithetical circumstances."[263]

Commentators on the Code have also argued that courts should base their decisions about whether to apply Code principles in common law cases on policy considerations.[264] James White and Robert Summers explain:

> required, even where the subject-matter had been intentionally excluded from the act in general. They implemented a statutory policy with liberal and useful remedies not provided in the statutory text. They disregarded a statutory limitation of remedy where the reason of the limitation did not apply. Nothing in the Uniform Commercial Code stands in the way of the continuance of such action by the courts.
>
> The Uniform Commercial Code should be construed in accordance with its underlying purposes and policies. The text of each section should be read in the light of the purpose and policy of the rule or principle in question, as also of the Uniform Commercial Code as a whole, and the application of the language should be construed narrowly or broadly, as the case may be, in conformity with the purposes and policies involved.

U.C.C. § 1-103 cmt. 1 (2001) (citations omitted).

[262] *See, e.g.*, 1A ANDERSON, *supra* note 230, § 2-102:24 (1996 rev. of vol. 1) ("There is a judicial tendency to apply Article 2 to transactions that are not only not sales of goods but that are not transactions within the scope of the Code." (footnote omitted)).

[263] Glenn Dick Equip. Co. v. Galey Constr., Inc., 541 P.2d 1184, 1190 (Idaho 1975) (quoting Note, *The Uniform Commercial Code as a Premise for Judicial Reasoning*, 65 COLUM. L. REV. 880, 888 (1965)). *See also, e.g.*, J.L. Teel Co. v. Houston United Sales, Inc., 491 So.2d 851, 857 (Miss. 1986) (adopting the methodology of *Glenn Dick*); William D. Hawkland, *Article 1: General Provisions* § 1-102:11 in HAWKLAND UNIFORM COMMERCIAL CODE SERIES (1998) (citing numerous cases in which courts have used analogies to "fill gaps and even, when reason and policy require, to extend a rule to subject matter which has been intentionally excluded from the [Code].").

[264] *See, e.g.*, Bruce W. Frier, *Interpreting Codes*, 89 MICH. L. REV. 2201, 2210 (1991). Frier observes that readers of a systematically codified body of law can use inductive reasoning to identify principles that find expression in more than one section. Those principles can then be applied not only to interpretive problems that

> We believe that the best general approach for courts to take is to determine what policy objectives the particular Code section in question implicates, and then, in light of those policies, determine whether the particular facts of the transaction invite the application of the section by analogy. . . . Of course, there may be a competing body of law, too, the policies of which must also be considered. And in a proper case, that body of law should control, not Article 2.[265]

The author of a student comment published nearly forty years ago advocated application of selected Code sections to franchise contracts on the basis of policy:

> The fact that franchise rights may be an analogue of Code goods should not be the primary focus of an analogical use. Rather, the court should look to the reasons which brought about the Code's statement of a particular rule to determine if these reasons are equally valid in the context of the franchise agreement.[266]

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arise within the Code but also, by analogy, to problems that arise outside the Code. *Id.*

[265] WHITE & SUMMERS, *supra* note 9, §1-1.

[266] Comment, *supra* note 9, at 984 (footnote omitted). The author continued:

> A corollary . . . is . . . that courts looking at a franchise agreement should be attuned to the same basic policies as those enunciated by the Code: (1) "to simplify, clarify and modernize the law governing commercial transactions;" (2) "to permit the continued expansion of commercial practices through custom, usage and agreement of the parties;" (3) "to make uniform the law among the various jurisdictions." While the analogical use of the Code may benefit only one of the parties to a distribution agreement during litigation, it is reasonable to assume that the application of a uniform act would ultimately benefit the entire industry by correcting some of the legal uncertainty that surrounds franchising.

Id. at 984-85 (footnotes omitted) (quoting U.C.C. § 1-102(2) (1962)). The author also suggested that in time a specialized body of law might govern franchising, lessening the need for application of general rules of contract law such as the Article 2 rules. *Id.* at 1009. With respect to express warranties in franchise sales, however, those specialized rules have yet to develop.

In short, there is strong support in case law, in the comments to the Code, and in academic commentary for extra-textual application of Code sections where the policies underlying those sections are apposite.[267]

B. *Express Warranties in the Common Law*

Brown may be able to find useful precedents in the law of real estate transactions, the law of service contracts, or the law governing sales of businesses.[268] In the real estate field, she will also find statutes and regulations that require warranties or disclosures by sellers in certain kinds of sales. The statutes may or may not be helpful, but in general the cases will offer Brown two kinds of support. First, of course, they will provide at least arguable analogies. And second, to the extent that they reflect the influence of sale-of-goods law on the common law, they are methodological precedents—examples of the kind of doctrinal development she will commend to the court.

1. Real Estate

In some reported cases, courts have enforced express warranties in real estate sales.[269] In *Johnson v. Healy*,[270] for example, the Connecticut Supreme Court considered claims made by the disappointed buyer of a new

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[267] Michael Garner sounds a cautionary note with respect to business format franchises, however:

> Some decisions have expressed the view that the Code's provisions are too rigid to accommodate a true franchise relationship, particularly a business format franchise, because, among other things, the interests of the parties are much broader than the interests of parties to a sale of goods. Moreover, in a franchise relationship, there are trademark and business format issues that the [Code] does not address; some would argue that a franchise involves a much more personalized relationship than a sale of goods. Thus, while some cases seem to have been quick to embrace the [Code], the courts should proceed with caution, particularly with respect to business format franchises.

2 GARNER, *supra* note 6, § 8:3 (footnote omitted).

[268] Brown will not be able to consult the law of warranties generally, according to two leading commentators, because there is no such law: "For the lawyer whose client has a warranty problem, there is no single source of warranty law. Instead, there are many interwoven strands, some statutory, some regulatory, and some judicial." 1 CLARK & SMITH, *supra* note 228, § 1:3.

[269] *See generally* 1 MILTON R. FRIEDMAN & JAMES CHARLES SMITH, FRIEDMAN ON CONTRACTS AND CONVEYANCES OF REAL PROPERTY § 2:1.3 (7th ed. 2008); Annotation, *Liability of Builder-Vendor or Other Vendor of New Dwelling for Loss, Injury, or Damage Occasioned by Defective Condition Thereof*, 25 A.L.R.3d 383 § 5 (1969 & Supp. 2008).

[270] 405 A.2d 54 (Conn. 1978).

home built by the seller. The seller, though experienced in the real estate business, had never built a home before, but the buyer learned of his inexperience only after the closing. Writing for the court, Justice Peters summarized the basis of the plaintiff buyer's claim:

> As part of the negotiations leading to the contract of sale of the house, the plaintiff inquired about the quality of its construction. The defendant replied that the house was made of the best material, that he had built it, and that there was nothing wrong with it. These representations were relied upon by the plaintiff and induced him to purchase the house. The damage which the house sustained because of its uneven settlement was due to improper fill which had been placed on the lot beneath the building at some time before the defendant bought the lot, as a building lot, in 1963.[271]

Neither the written sales agreement nor the deed contained any express warranties concerning the construction of the house. Yet the supreme court upheld the lower court's decision finding the seller liable.

At least three aspects of *Johnson* are helpful to Brown. First, like her case, it involved a buyer who relied upon but did not receive a competent performance by the seller. Just as Brown learned of Swift's lack of expertise only after buying her franchise, the buyer in *Johnson* learned of the seller's inexperience in construction only after buying the house. Second, just as Brown's Franchise Agreement did not incorporate Paula's affirmation and promise, the real estate contract did not include the seller's assurances of quality. Third, the real estate seller's statement was much less formal than the disclosure document Brown received. Justice Peters explained why such an informal assurance was enforceable:

> Although indefinite, the [seller's] statement that there was "nothing wrong" with the house could reasonably have been heard by the [buyer] as an assertion that the [seller] had sufficient factual information to justify his general opinion about the quality of the house. In context, this statement of opinion could reasonably have induced reliance.[272]

If an assurance as vague as the seller's can be a basis for warranty liability, Paula's formal affirmation and promise should surely be enforceable as warranties.

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[271] *Id.* at 55-56.
[272] *Id.* at 57.

Johnson also illustrates the judicial methodology that Brown advocates. The plaintiff had pled misrepresentation, and the trial court had found the seller liable on that theory but had also "concluded that the [seller] had made an express warranty coextensive with the doctrine of implied warranty of workmanship and habitability in cases involving the sale of new homes by a builder."[273] Justice Peters, a former professor of commercial law, wrote that in the United States express warranty law had become "firmly established, no later than the promulgation of the Uniform Sales Act in 1906."[274] The Code had clarified "basic remedial principles" of earlier warranty law, and those principles retained their strength in the wake of its enactment.[275] Noting the convergence of warranty and strict liability for innocent misrepresentation, Peters wrote that Connecticut courts had applied the doctrine of innocent misrepresentation to the sale of goods as early as 1850.[276] In a case decided in 1932,[277] the court had applied that doctrine to a construction contract, reasoning that the contractor's misrepresentation was actionable "in analogy to the right of a vendee to elect to retain goods which are not as warranted, and to recover damages for the breach of warranty."[278] The 1850 case and the 1932 case made "clear that liability for innocent misrepresentation is not a novelty in [Connecticut], that such liability is based on principles of warranty, and that such warranty law is not confined to contracts for the sale of goods."[279] Policy considerations relating to real estate sales justified extending "warranty liability for innocent misrepresentation to a builder-vendor who sells a new home . . . ."[280]

Despite the emphasis on misrepresentation as well as warranty in both the trial court and the Connecticut Supreme Court, the plaintiff was entitled to an expectation remedy. The measure of damages was the

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[273] *Id.* at 56.
[274] *Id.*
[275] 405 A.2d at 56.
[276] *Id.* (citing Bartholomew v. Bushnell, 20 Conn. 271 (1850)).
[277] E. & F. Constr. Co. v. Stamford, 158 A. 551 (1932).
[278] *Johnson*, 405 A.2d at 57 (quoting E. & F. Constr. Co. v. Stamford, 158 A. 551, 553 (1932)).
[279] *Id.*
[280] *Id.* (footnote and citation omitted). *See also* Cousineau v. Walker, 613 P.2d 608, 611 n.4 (Alaska 1980). In *Cousineau*, a buyer of real estate sued for rescission based on innocent misrepresentations by the seller. The court wrote that, although the Code did not apply directly, its warranty provisions were illuminating:

> We do not contend that real property transactions are the same as those involving sales of goods. Nevertheless, an analogy to the applicability of the doctrine of caveat emptor under the Uniform Commercial Code is helpful. Under the Code, factual statements regarding the sale of goods constitute an express warranty.

Id. at 615 (footnote omitted).

difference between the value of the property if it had been as warranted and its value as delivered.[281] In a case that the Code did not govern, then, the court applied an express warranty rule that was rooted in part in law governing sales of goods.[282]

Other courts have upheld enforcement of express warranties in real estate sales[283] or held that express warranty claims stated causes of action.[284] Still others have stated in *dicta* that those claims can be viable.[285] In *Dittman v. Nagel*,[286] for example, the court concluded that a contract for the sale of a used home included an express warranty. There was, the court wrote, "very little case law which discusse[d] express warranties of quality as they apply to realty."[287] Although the Code warranty provisions did not apply to the sale of real estate, and although the court did not cite section 2-313, it did suggest that the Code principles could help to fill the common law vacuum: "the legal principles which have developed regarding express warranties as they apply to the sale of goods certainly appear to be equally applicable to an express warranty of quality involved in a sale of realty."[288]

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[281] *Id.* at 58-59. *See* DOBBS, *supra* note 24, § 483 (expectation relief is appropriate if "the innocent misrepresentation is a true contractual warranty, that is, an implicit or explicit understanding of the parties.").

[282] For criticism, see DOUGLAS J. WHALEY, WARRANTIES AND THE PRACTITIONER 234 (1981) (By adopting a tort theory, the court "neatly side-stepped" the statute of frauds and the parol evidence rule.).

[283] *See, e.g.*, Krupp v. Fed. Hous. Admin., 285 F.2d 833, 834-35 (1st Cir. 1961) (statement by Federal Housing Administration in prospectus describing real estate to be sold constituted warranty); Meyers v. Antone, 227 A.2d 56 (D.C. 1967) (enforcing warranty of functioning heating system given by seller who built home); A.W. Easter Const. Co. v. White, 224 S.E.2d 112 (Ga. Ct. App. 1976) (express warranties of quality in sale of new home built by the seller); Bethlahmy v. Bechtel, 415 P.2d 698, 704 (Idaho 1966) (enforcing oral warranty given by seller who built home that home was "built of the finest materials and by the finest workmen available and that it would be a fine home"); Flom v. Stahly, 569 N.W.2d 135, 139-42 (Iowa 1997) (enforcing express warranties in writings which, the court concluded, the parties had expressly incorporated in their sales agreement); Caparrelli v. Rolling Greens, Inc., 190 A.2d 369 (N.J. 1963) (enforcing oral warranty of habitable basement in new home against seller who built home).

[284] *See, e.g.*, Winstead Land Dev. Co. v. Design Collaborative Architects, No. CV 960071571, 1997 Conn. Super. Lexis 1501, *3-5 (Conn. Super. Ct. June 2, 1997) (following Johnson v. Healy, 405 A.2d 54 (Conn. 1978)); Neppl v. Murphy, 736 N.E.2d 1174, 1178-84 (Ill. App. Ct. 2000); Edwards v. Schuh, 5 S.W.3d 829, 832-33 (Tex. App. 1999).

[285] *See, e.g.*, Dittman v. Nagel, 168 N.W.2d 190 (Wis. 1969) (sellers gave express warranty of quality of well water but buyers failed to show breach of warranty); Garriffa v. Taylor, 675 P.2d 1284 (Wyo. 1984) (real estate sellers can give express warranties, but evidence in case did not support finding of express warranty regarding septic system).

[286] 168 N.W.2d 190 (Wis. 1969).

[287] *Id.* at 193.

[288] *Id.*

Some courts, moreover, have applied other Code warranty policies to real estate sales.[289]

At least four factors, however, may tend to limit the number of real estate cases that can provide analogies for Brown. First, in some cases in which the courts have found express warranties in real estate sales, the warranties were included or incorporated by reference in the written contract for sale.[290] Those cases do not stand for the proposition that, in the absence of helpful language in the contract of sale, warranty law draws into that contract affirmations or promises made during the negotiation phase.

Second, there are some potential doctrinal obstacles to claims like those of the plaintiff in *Johnson*. Contracts for the sale of real estate are subject to the statute of frauds, and there is some authority for the proposition that an oral express warranty is unenforceable under the statute.[291] If a written sales agreement does not include a warranty, evidence of the warranty may be inadmissible under the parol evidence rule.[292] And even if the warranty is included in the written sales agreement, it may fall victim to the merger doctrine[293] if it is not included in the deed.[294] Although some buyers have succeeded in overcoming one or more of those obstacles,[295] others may have either decided not to litigate or litigated without establishing precedents that Brown can use.[296]

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[289] *See, e.g.*, Lake Bluff Heating & A.C. v. Harris Trust, 452 N.E.2d 1361, 1367 (Ill. App. Ct. 1983) (applying policy of Code § 2-316(1) on disclaimers of express warranties).

[290] *See, e.g.*, Neppl v. Murphy, 736 N.E.2d 1174, 1177 (Ill. App. Ct. 2000); Flom v. Stahly, 569 N.W.2d 135, 138, 140 (Iowa 1997).

[291] *See* 1 CLARK & SMITH, *supra* note 228, § 2:31. As Clark and Smith acknowledge, however, the buyer may argue successfully that the warranty is collateral to the sale and that it is not an essential term of the sales agreement for purposes of the statute. *Id. See also* RICHARD A. POWELL, POWELL ON REAL PROPERTY § 14:81.02[1][d][i] (Michael Allan Wolf ed. 2000).

[292] *See* 1 CLARK & SMITH, *supra* note 228, § 2:31.

[293] *See* 2 FRIEDMAN & SMITH, *supra* note 269, § 8:16 ("Upon the buyer's acceptance of the deed, merger takes place. The seller's obligations under the contract of sale with respect to the conveyance are discharged, and thereafter the buyer's rights are based solely on the warranties, if any, in the deed.").

[294] 1 CLARK & SMITH, *supra* note 228, § 2:31. *But see* 2 FRIEDMAN & SMITH, *supra* note 269, § 8:16 ("[W]here the contract of sale creates rights collateral to or independent of the conveyance, those rights survive delivery of the deed." (footnote omitted)); Caparrelli v. Rolling Greens, Inc., 190 A.2d 369, 372 (N.J. 1963) (seller's oral warranty in sale of new home collateral to transfer of title and therefore not merged in deed).

[295] *See* 1 CLARK & SMITH, *supra* note 228, § 2:31. *See also, e.g.*, Meyers v. Antone, 227 A.2d 56, 57 (D.C. 1967) (warranty included in written sales agreement collateral to transfer of title and therefore not merged in deed); *Caparrelli*, 190 A.2d at 372 (seller's oral warranty in sale of new home collateral to transfer of title and therefore not merged in deed).

[296] *See, e.g.*, Marc Galanter & Mia Cahill, *"Most Cases Settle": Judicial Promotion and Regulation of Settlements*, 46 STAN. L. REV. 1339, 1340 (1994). Galanter and

The third factor is the body of statutory law that governs many modern real estate transactions.[297] In some states, for example, sales of condominiums, coops, and planned communities are governed by the Uniform Common Interest Ownership Act.[298] That act contains a section providing for the creation of express warranties which closely resembles U.C.C. section 2-313.[299] In some other states, condominium sales are governed by the Uniform Condominium Act,[300] which includes an identical provision.[301]

Some states have adopted laws that govern express warranties in the sale of new homes,[302] and many have adopted statutes that require sellers of used homes to fill out and provide to buyers disclosure forms concerning the condition of the property to be sold.[303] Although the disclosures do not constitute warranties,[304] failure to provide the required information can subject sellers to liability to their buyers.[305] Some real estate sales are subject to the disclosure requirements of the Federal Interstate Land Sales Full Disclosure Act.[306] That Act provides purchasers of property with a right of action against developers who fail to provide the requisite disclosure.[307] Moreover, several states have adopted the Uniform

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Cahill note that "two-thirds of cases . . . settle without a definitive judicial ruling." *Id.* Of the other third, moreover, by no means all culminate in reported opinions. *See, e.g.*, Brian N. Lizotte, *Publish or Perish: The Electronic Availability of Summary Judgments by Eight District Courts*, 2007 WIS. L. REV. 107, 149 (2007) (concluding that "[p]ublished summary-judgment grants are only a small subset of all such grants in the federal courts.").

[297] Any such statutes in Brown's jurisdiction may or may not help her persuade the court to find common law express warranties in her case. *See infra* text at note 315.

[298] There are two versions of the Act. *See* UNIF. COMMON INTEREST OWNERSHIP ACT §§ 1-101 to 5-110, 7 U.L.A. PART I 840-1009 (2005); UNIF. COMMON INTEREST OWNERSHIP ACT §§ 1-101 to 5-110, 7 U.L.A. PART II 1-174 (2002).

[299] *See* UNIF. COMMON INTEREST OWNERSHIP ACT § 4-113, 7 U.L.A. PART I, at 990-91 (2005); UNIF. COMMON INTEREST OWNERSHIP ACT § 4-113, 7 U.L.A. PART II, at 149-50 (2002).

[300] *See* UNIF. CONDOMINIUM ACT §§ 1-101 to 5-110, 7 U.L.A. PART II 457-637 (2002).

[301] *See id.* § 4-113, at 611-12.

[302] *See, e.g.*, CONN. GEN. STAT. § 47-117 (2007).

[303] *See generally* George Lefcoe, *Property Condition Disclosure Forms: How the Real Estate Industry Eased the Transition from Caveat Emptor to "Seller Tell All,"* 39 REAL PROP. PROB. & TR. J. 193 (2004).

[304] *Id.* at 212 ("Disclosure statutes uniformly caution that a seller's truthful disclosure is not to be taken as a warranty of the condition of the property being sold. Similarly, disclosure forms typically proclaim, sometimes in a big, bold font: 'This is not a warranty.'").

[305] *Id.* at 230-31.

[306] 15 U.S.C. §§ 1701-1720 (2006).

[307] *Id.* § 1709(a).

Land Sales Practices Act,[308] which provides for registration[309] and disclosure[310] and gives buyers a private action for violations.[311] These statutes and, in some cases, their accompanying regulations, may have reduced the incentives for disappointed buyers to sue for breach of common law express warranties in real estate sales.[312]

The fourth factor is the increasing frequency with which builders, their buyers, and sometimes third parties, are employing written warranty contracts designed to be delivered to the buyer at the closing.[313] Although this trend might seem likely to lead to more litigation and thus more reported cases, the use of what amounts to warranty insurance[314] may in fact prevent many disputes from reaching the litigation stage. A related practice which may have the same effect is disclosure pursuant to a term in

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[308] UNIF. LAW COMMISSIONERS' MODEL LAND SALES PRACTICES ACT §§ 1-24, 7A U.L.A. PART II 210-43 (2006).
[309] *Id.* § 5, at 217-19.
[310] *Id.* § 6, at 220-21.
[311] *Id.* § 16, at 236-37.
[312] The statutes may have limited the development of the common law of express warranties in real estate sales even though, "[f]or the most part, [those that require the completion of seller disclosure forms] have been drafted to complement, but not to modify or otherwise interfere with, the evolving common law of seller disclosure." Lefcoe, *supra* note 303, at 199. Lefcoe adds that "[s]ellers remain obligated to disclose known material latent defects (as defined by courts over time) not readily observable to buyers." *Id.* Moreover, to the extent that the statutes effectively provide for private enforcement, they are not likely to generate precedents that will be useful to Brown, who must contend with the lack of a private action under the FTC Rule.
[313] Friedman and Smith describe this trend:

> Many larger builders offer their own express warranties in a standardized form, but more significant are warranties given or guaranteed by third parties. For example, the Residential Warranty Corporation . . . is presently the largest national issuer of third-party warranties for new housing. It offers warranties on new homes, including manufactured homes, as well as remodeling projects. Builders who wish to provide [the corporation's] policies to their buyers must apply for membership in the [corporation's] program and meet specified standards. A buyer who purchases from a participating builder receives a written . . . policy, which insures against a range of defects for certain time periods that vary according to the type of defect. The builder pays a small premium to the [corporation] for the policy.

1 FRIEDMAN & SMITH, *supra* note 269, § 2:1.3 at 2-23 (footnotes omitted).
[314] *See supra* note 313.

either the listing agreement or the contract for sale,[315] even in the absence of a statutory or administrative requirement.

Brown can argue, of course, that even as statutes and regulations tend to inhibit the development of the common law of express warranties in real estate, they also represent legislative and administrative endorsements of the principal policy of Code section 2-313: that the seller should have to stand behind what he or she said to procure the sale. The court may agree. On the other hand, it may reason that the legislature or agency deliberately chose to regulate real estate sales but not franchise sales. If so, the court is unlikely to regard the statute or regulation as helpful to Brown.

2. Services

Brown may find some helpful precedents in the law governing contracts for the sale of services. Perhaps the most famous case involving an express warranty in a service contract is the venerable *Hawkins v. McGee*,[316] in which the New Hampshire Supreme Court enforced a doctor's warranty that surgery would give his patient "a hundred percent good hand."[317] A more modern example in the medical context is *Sullivan v. O'Connor*,[318] in which the Supreme Judicial Court of Massachusetts upheld an award of reliance damages to a patient whose cosmetic surgery failed to produce the result her doctor had promised. Other warranties of specific medical results have led to liability in some cases.[319]

Many construction contracts contain express warranties,[320] and some construction cases may furnish helpful analogies.[321] In *Anthony's*

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[315] Either the listing agreement or the purchase and sale agreement, or both, may require the seller to provide disclosure to the buyer. *See* Lefcoe, *supra* note 303, at 229.

[316] 146 A. 641 (N.H. 1929).

[317] *Id.* at 643.

[318] 296 N.E.2d 183 (Mass. 1973).

[319] *See* Mills v. Pate, 225 S.W.3d 277, 289-91 (Tex. App. 2006) (reversing grant of summary judgment for doctor on patient's claim of breach of express warranty). *See generally* Jack W. Shaw, Jr., *Recovery Against Physician on Basis of Breach of Contract to Achieve Particular Result or Cure*, 43 A.L.R.3d 1221 (1972 & Supp. 2008).

[320] *See, e.g.*, IRV RICHTER & ROY S. MITCHELL, HANDBOOK OF CONSTRUCTION LAW AND CLAIMS 238-40 (1982); *id.* at 238 ("Construction contracts commonly include a guaranty or warranty clause."); AIA Document A107-1997, *Abbreviated Standard Form of Agreement Between Owner and Contractor for Construction Projects of Limited Scope where the basis of payment is a STIPULATED SUM* Article 8.4, *reprinted in* E. ALLAN FARNSWORTH & WILLIAM F. YOUNG, SELECTIONS FOR CONTRACTS 355, 361 (2003).

[321] *See* William K. Jones, *Economic Losses Caused by Construction Deficiencies: The Competing Regimes of Contract and Tort*, 59 U. CIN. L. REV. 1051, 1066 (1991) ("If a seller has made representations, an action may lie for breach of express warranty or for misrepresentation." (footnote omitted)). For an argument in favor of application of Code rules in construction cases, see Emmie West, Note,

Pier Four, Inc. v. Crandall Dry Dock Engineers, Inc.,[322] for example, the Supreme Judicial Court of Massachusetts treated statements that were not incorporated in a formal contract of sale as express warranties. The case involved a company that had designed a foundation and mooring system for a ship so that the ship could serve as a cocktail lounge for an onshore restaurant in Boston. The ship broke loose during a storm and capsized, and the owner of the restaurant sued the company for breach of an express warranty.

The company moved for summary judgment with respect to the owner's claim that he had suggested a specific design modification to strengthen the system and better protect the ship—a modification that the company had rejected on the basis that its design was sufficient.[323] The trial court granted the motion, but the supreme judicial court reversed:

> In rejecting the suggestion, [the company] assured the [owner] that its work would be fit for the intended purpose of permanently mooring the ship. Such an assurance would impose a higher standard of performance on [the company] than its implied warranty of reasonable care. Therefore, there is evidence from which a fact finder could conclude that [the company] made assurances amounting to an express warranty.[324]

Although statements lacking that degree of specificity would not constitute express warranties,[325] the owner was entitled to a trial on the issue of the design modification.

In 2005, a Texas appellate court decided a case that more closely resembles Brown's.[326] Jacqueline Head contracted with a company called U.S. Inspect DFW for an inspection of a house in Fort Worth which she had agreed to buy. Under the inspection contract, a "licensed real estate inspector" was to perform the inspection.[327] The contract "specified that

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Construction Contracting: Building Better Law With the Uniform Commercial Code, 52 CASE W. RES. L. REV. 1067, 1084 (2002). West advocates application of the Code to all hybrid construction contracts.

[322] 489 N.E.2d 172 (Mass. 1986).

[323] *Id.* at 173, 178 (citations omitted).

[324] *Id.* at 178.

[325] Summary judgment for the company was proper, the supreme judicial court wrote, with respect to other claims of breach of warranty. The owner claimed, for example, that the company had assured him that the design would be "adequate and sufficient for the purposes for which it was intended." Without "any more specific language, or indication of the circumstances in which [the owner] was so 'informed,'" the court wrote, "[the company's] statements appear to be no more than opinions that lack a promissory nature." *Id.*

[326] Head v. U.S. Inspect DFW, 159 S.W.3d 731 (Tex. App. 2005).

[327] *Id.* at 735.

neither the inspection nor the report would include any warranties, express or implied, unless specifically stated."[328] An "apprentice inspector," who was neither licensed nor supervised by a licensed inspector, inspected the attic and roof of the house and failed to discover serious defects that had resulted in substantial water damage.[329] After discovering the defects, Head sued U.S. Inspect for violation of the Texas Deceptive Trade Practices Act ("DTPA").

Head needed to establish that the provision entitling her to an inspection by licensed inspector was a breach of an express warranty that violated the DTPA. The statute prohibits "[f]alse, misleading, or deceptive acts or practices in the conduct of any trade or commerce"[330] and includes a laundry list of prohibited practices.[331] Unfortunately for Head, that list does not include breach of an express warranty. The court concluded, however, that an exception within an exemption indicates that a breach of warranty can constitute a violation. The DTPA exempts "the rendering of a professional service, the essence of which is the providing of advice, judgment, opinion or similar professional skill."[332] And that "exemption does not apply to . . . breach of an express warranty that cannot be characterized as advice, judgment, or opinion . . . ."[333] The exception for express warranties that "cannot be characterized as advice, judgment, or opinion" implies that breaches of express warranties that cannot be so characterized can violate the DTPA.

The court observed that the DTPA neither defines nor creates any warranties. To prove an actionable breach of warranty, therefore, a plaintiff must demonstrate the existence of a warranty under a statute or the common law. Head alleged breaches of express warranties "set forth in the inspection [contract (1)] that . . . 'a licensed professional real estate inspector would perform the inspection'" and (2) "that the inspection would be conducted in accordance with the standards of the Texas Real Estate Commission."[334] In the absence of an applicable statute concerning warranties, the question was whether the common law recognized those warranties.

The court gave an affirmative answer. "Because warranty law has developed mainly in transactions involving goods," the court wrote, "we may look to the [U.C.C.], which concerns express warranties and the sale of goods, for guidance."[335] Following an earlier case in which the Supreme Court of Texas had applied Code express warranty concepts in the context

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[328] *Id.* at 735.
[329] *Id.*
[330] TEX. BUS. & COM. CODE ANN. § 17.46(a) (Vernon 2002).
[331] *Id.* § 17.46(b).
[332] *Id.* § 17.49(c).
[333] *Id.* § 17.49(c)(4).
[334] *Head*, 159 S.W.3d at 746.
[335] *Id.*

of a service contract,[336] the *Head* court denied summary judgment to U.S. Inspect. The contract provision requiring inspection by a "licensed inspector" was a promise "as to the quality of future services to be provided,"[337] and promises with respect to quality can create express warranties under section 2-313. Head's evidence that U.S. Inspect had breached its promise was evidence of a breach of warranty and thus of a violation of the DTPA.

Although there are some differences,[338] the parallel between Head's case and Brown's is striking. Like U.S. Inspect, Paula's made and failed to perform a promise to provide expert assistance. Like the Texas court, the court in Brown's case should be guided by the Code to a finding that Brown has a claim for breach of an express warranty.[339]

Brown may be able to find other helpful precedents involving service contracts, but she is by no means assured of doing so in her jurisdiction. Courts have generally judged the performance of service contracts by reference to concepts such as material breach[340] and negligence.[341] The negligence approach, which focuses on the skill with which the service provider performed, may be conducive to skepticism

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[336] Southwestern Bell Tel. Co. v. FDP Corp., 811 S.W.2d 572 (Tex. 1991).

[337] *Head*, 159 S.W.3d at 747.

[338] The promise the court enforced in *Head* was in the inspection contract, 159 S.W.3d at 742, so Head did not need to cite comment 3 to § 2-313, which makes clear that affirmations and promises made during the negotiation process can create warranties that are part of the contract for sale. *See* UCC § 2-313 cmt. 3 (2002). Moreover, Head was a consumer and thus able to sue under the DTPA. *See* TEX. BUS. & COM. CODE ANN. § 17.50(a)(2) (Vernon 2002).

[339] For an additional Texas case recognizing a breach of express warranty claim in a service transaction, see *Blackwood v. Tom Benson Chevrolet Co.*, 702 S.W.2d 732 (Tex. App. 1985) (express warranty of quality of vehicle repair services).

[340] Raymond T. Nimmer, *Services Contracts: The Forgotten Sector of Commercial Law*, 26 LOY. L.A. L. REV. 725, at 740 (1993) ("The cases emphasize a concept of substantial performance and permit complete nonpayment only in the face of a material breach.").

[341] William Jones describes the prevailing approach:

> The "proper efforts" standard is common in service contracts, particularly in the case of professionals such as doctors, lawyers, architects and engineers. In general, courts construe these contracts as imposing no more than an obligation to employ proper efforts, in conformity with standards of the profession, and there is no breach even if the objective of the contract is not achieved—the patient dies, the lawsuit is lost, the building collapses—as long as the contracting party has made the proper effort.

Jones, *supra* note 321, at 1059 (footnotes omitted). *See also* Nimmer, *supra* note 340, at 740 ("The circumstances [of a service contract] lend themselves to a reasonable person approach that closely resembles negligence law standards.").

about express warranties in service contracts.[342] That skepticism may inhibit buyers of services from asserting express warranty claims, thus limiting the number of reported cases. In the view of at least one commentator, moreover, the law of service contracts generally is not well developed:

> The law on services *contracts* comes from both common law and scattered statutes. It contains an array of uncertain legal doctrines. In contrast, commercial sales of goods are governed by articulate, codified rules, which receive extensive attention in legal literature and are being rewritten for a second time in forty years to reflect modern developments. The imbalance could not be more blatant, nor could it be more unfortunate. It is time, actually long past time, to include services contracts in the U.C.C.[343]

The service warranty cases that Brown is able to locate, then, may not constitute a coherent body of case law, much less a solid foundation for her express warranty claim.

3. Businesses

A third possible source of analogies for Brown is the law regarding express warranties in contracts for the sale of businesses. Given the fact that she bought the right to operate a business using Paula's name and system, that law might seem to be a rich lode of cases that would either support or undercut her arguments. In practice, however, express warranties in corporate acquisitions and mergers are often included in the written contract of sale, and sometimes explicitly survive the closing.[344]

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[342] *See, e.g.*, Sullivan v. O'Connor, 296 N.E.2d 183, 185 (1973) (causes of action for breach of contract in doctor-patient setting "considered a little suspect . . . .").

[343] Nimmer, *supra* note 340, at 728-29. West highlights the Code's accessibility:

> [M]any [Code] provisions are codifications of existing common law principles. Part of the advantage in applying the [Code] to hybrid construction contracts is not related to differences between [the Code] and common law, but to the fact that the [Code] sets forth general contracting principles in a clear, organized way with a body of law that is recognized across jurisdictions. It makes no difference that some of these principles are identical to common law; construction industry professionals, their lawyers, and judges all can refer to the [Code] with greater ease than to the current amalgamation of common law principles.

West, *supra* note 321, at 1084 (footnotes omitted).

[344] *See generally* WILLIAM J. CARNEY, MERGERS AND ACQUISITIONS 162 (2d ed. 2007) ("The center of the acquisition agreement becomes the representations and warranties given by the seller."); THERESE H. MAYNARD, MERGERS AND

Paula's affirmation and promise, of course, were neither explicitly stated as warranties nor included in the Franchise Agreement. As a result, much of the case law concerning express warranties in sales of businesses is not relevant to the issue of whether the affirmation and promise were part of the Franchise Contract.[345]

The business cases may shed some light on the nature of any reliance requirement that the court may impose on Brown. The law on that point, however, will depend on her jurisdiction. Some courts hold that the seller of a business can defeat the express warranty claim of his or her buyer if the buyer did not rely on the truth of the seller's warranty. If, for example, the buyer had reason to believe that the seller's statement was false, some courts will deny recovery. Other courts hold, however, that the only showing the buyer need make is that he or she relied on the existence of the warranty, as opposed to its truth.[346] Commentators who regard

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ACQUISITIONS: CASES, MATERIALS, AND PROBLEMS 309-11 (2005); JERE D. MCGAFFEY, BUYING, SELLING AND MERGING BUSINESSES § 1.04(b) (2d ed. 1989) ("The most lengthy part of the acquisition agreement is normally the representation and warranty section.").

[345] An exception may be *Land v. Roper Corp.*, 531 F.2d 445 (10th Cir. 1976). During the negotiations for the sale of a company, the seller, Land, gave the buyer, Roper, an unaudited interim financial statement for a period that ended several weeks before the closing of the transaction. After the closing, Roper sued, claiming breaches of two express warranties:

> First, the representation by Land that the financial statement . . . had been prepared in accordance with generally accepted accounting principles applied on a consistent basis throughout the period involved and presented fairly the financial position of the Land company as of the dates thereof and the results of operations and changes in the financial positions for the period indicated.
>
> Secondly, it was represented that there had been no adverse changes in the business, property or general financial condition of the Land Company as reflected by said financial statements . . . .

Id. at 447. The opinion does not make clear in what form Land made those representations, although they may have been oral or otherwise outside the contract of sale. If they were outside the contract, the case is consistent with White's view that reliance should be necessary in cases in which alleged warranties are not part of the contract "under conventional definitions of contract." White, *supra* note 242, at 2109-10. See *supra* text at notes 242-46. The Tenth Circuit upheld the district court's judgment in favor of Land in part because there was substantial evidence to support the district court's finding that Roper had made an independent investigation of the financial condition of the business and had not relied on the representations. *Land*, 531 F.2d at 449. Both courts applied Kansas law.

[346] *See* Frank J. Wozniak, *Purchaser's Disbelief in, or Nonreliance Upon, Express Warranties Made By Seller in Contract for Sale of Business as Precluding Action for Breach of Express Warranties*, 7 A.L.R. 5th 841 (1992 & Supp. 2007).

express warranty claims as purely contractual tend to favor the latter view.[347]

C. The FTC Rule

Brown may persuade the court that Code warranty policies support extension of the common law of express warranties into the arena of franchise sales, but she will recover only if the court admits her evidence of express warranties. Because Paula's affirmation and promise concerning site selection assistance are extrinsic to the Franchise Agreement, which contains a merger clause, the company will argue that her evidence, in the form of the disclosure document, is inadmissible.[348]

Under the newly revised FTC Rule, however, it is illegal for a franchisor to disclaim in a franchise agreement affirmations or promises made in a disclosure document:

> It is an unfair or deceptive act or practice in violation of Section 5 of the Federal Trade Commission Act for any franchise seller covered by [the Rule] to:
>
> (a) Make any claim or representation, orally, visually, or in writing, that contradicts the information required to be disclosed by this part.
>
> . . .
>
> (g) Present for signing a franchise agreement in which the terms and conditions differ materially from those presented as an attachment to the disclosure document, unless the franchise seller informed the prospective franchisee of the differences at least seven days before execution of the franchise agreement.
>
> (h) Disclaim or require a prospective franchisee to waive reliance on any representation made in the disclosure document or in its exhibits or amendments. Provided, however, that this provision is not intended to prevent a prospective franchisee from voluntarily waiving specific contract terms and conditions set forth in his or her

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[347] *See* Kwestel, *supra* note 240; Matthew J. Duchemin, Comment, *Whether Reliance on the Warranty is Required in a Common Law Action for Breach of An Express Warranty?*, 82 MARQ. L. REV. 689 (1999).

[348] For discussion of the parol evidence rule as applied to the statements in the disclosure document, see *supra* notes 205-24 and accompanying text.

> disclosure document during the course of franchise sale negotiations.[349]

Subject to the proviso in subsection (h), then, any franchise agreement provision designed to disclaim an affirmation or promise in the disclosure document should be unenforceable. The FTC's Statement of Basis and Purpose explains the Agency's reasoning: "The use of integration clauses or waivers to disclaim statements in the disclosure document that the franchisor authorizes would undermine the Rule's very purpose by signaling to prospective franchisees that they cannot trust or rely upon the disclosure document."[350] Although the Agency has declined to prohibit the use of merger, or integration, clauses in franchise agreements altogether,[351] it clearly believes that the clauses should not shield franchisors from the consequences of improper disclosure.

Paula's will respond to Brown's illegality argument by citing the proviso in (h), arguing that the integration clause in the Franchise Agreement is not illegal because it represents her voluntary waiver of "specific contract terms and conditions set forth in [the] disclosure document during the course of franchise sale negotiations."[352] On the distinction between a permissible waiver and an impermissible merger clause or disclaimer, Brown will argue that a permissible waiver must refer

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[349] 16 C.F.R. § 436.9 (2008).

[350] 2007 Statement of Basis and Purpose, *supra* note 32, at 15,534 (footnotes omitted).

[351] *See* 16 C.F.R. § 436.9 (2008). For the Agency's reasoning, see 2007 Statement of Basis and Purpose, *supra* note 32, at 15,533-34.

The FTC's Franchise Rule—2008 Compliance Guide includes a sample merger and disclaimer provision that would comply with the Rule:

> This Agreement and all exhibits to this Agreement constitute the entire agreement between the parties and supersede any and all prior negotiations, understandings, representations, and agreements. Nothing in this or in any related agreement, however, is intended to disclaim the representations we made in the franchise disclosure document that we furnished to you.
>
> You acknowledge that you are entering into this Agreement as a result of your own independent investigation of our franchised business and not as a result of any representations about us made by our shareholders, officers, directors, employees, agents, representatives, independent contractors, or franchisees that are contrary to the terms set forth in this Agreement, or in any disclosure document, prospectus, or other similar document required or permitted to be given to you pursuant to applicable law.

Compliance Guide, *supra* note 351, Sample Integration Provision, at 143.

[352] 16 C.F.R. § 436.9(h) (2008).

explicitly to specific terms set forth in the disclosure document.[353] The FTC agrees; the Statement of Basis and Purpose explains the need for waivers in a limited class of cases:

> [The waiver] proviso is necessary because, in its absence, a franchisor might conclude that it is prohibited from agreeing to any terms or conditions not spelled out in the standard agreement attached as an exhibit to its disclosure document. Clearly, franchise sellers and prospective franchisees should be free to negotiate the terms of the franchise agreement, as in all other commercial transactions. The [FTC] has no interest in preventing the parties from seeking the best deal possible, as long as the prospective franchisee understands in advance of the sale how the terms and conditions differ from the standard ones set forth in the disclosure document and has the opportunity to review the actual franchise agreement prior to the sale.[354]

The proviso in subsection (h), then, is designed to apply only to differences between the terms of the standard agreement and the agreement the prospective franchisee signs. A waiver could relieve the franchisor of liability for failure to perform a promise made in the standard agreement but, as a result of a choice by the franchisor and the franchisee, not included in the franchisee's agreement. The waiver could not, however, affect liability based on a either a false or deceptive affirmation of fact in the disclosure document[355] or a promise made in the disclosure document but not repeated in the standard agreement.

To ensure the admission of her evidence of express warranties, Brown must do more than establish the illegality of Paula's merger clause to the extent that it effectively negates affirmations or promises in the

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[353] Brown's argument is consistent with the notion that underlies the Code's refusal to give legal effect to disclaimers of express warranties in section 2-316. Buyers, the Code drafters thought, needed protection against "unexpected and unbargained language of disclaimer." *See* U.C.C. § 2-316 cmt. 1 (2002).

[354] 2007 Statement of Basis and Purpose, *supra* note 32, at 15,535 (footnote omitted).

[355] The waiver would not, for example, affect the franchisor's liability for a false affirmation of fact made under subsection 436.5(b) on business experience or (d)(1) on bankruptcy. Subsection (b) requires disclosure of the identities of "individuals who will have management responsibility relating to the sale or operation of franchises," as well as the "principal positions and employers" of each of those individuals. Subsection (d) requires disclosure of whether, during the 10-year period ending on the date of the disclosure document, any of those individuals has, among other things, "filed as debtor (or had filed against it) a petition under the United States Bankruptcy Code . . . ." 16 C.F.R. § 436.5 (2008).

disclosure document. She must also persuade the court that the clause should be unenforceable to that extent. Although courts have frequently refused to enforce contract provisions that violate statutes or administrative regulations, they have not always done so.[356] With respect to provisions that violate statutes, Allan Farnsworth explains that "[a] court may conclude that the sanction explicitly provided by the legislature is adequate to further the statute's underlying policy, without the additional sanction of unenforceability."[357]

Brown will probably prevail, however. "As a general rule, an illegal bargain is unenforceable and, often void."[358] Although the Franchise Agreement as a whole does not necessarily offend public policy, the merger clause does insofar as it applies to affirmations and promises in the disclosure document, and courts have not hesitated to strike illegal clauses from otherwise enforceable contracts.[359] As the FTC observes, enforcement of the merger clause to discharge those affirmations and promises would be completely contrary to the purpose of the law that the clause violates.[360]

Even if the merger clause is unenforceable insofar as it relates to promises and affirmations in the disclosure document, however, under either Williston's or Corbin's approach to the parol evidence rule,[361] the court could in theory conclude that the Franchise Agreement was a complete integration that made evidence of any site selection agreement inadmissible. Under Williston's approach, the Franchise Agreement could appear complete and the court could decide that a reasonable person in Brown's position would not have signed it while believing that she was contractually entitled to expert site selection assistance.[362] Under Corbin's approach, the court would be much less likely to find a complete integration.[363] Yet the court might decide that Brown's execution of the Franchise Agreement manifested an intention to discharge any site selection promise, perhaps in exchange for some other concession by the company.[364]

On the whole, however, Brown is likely to prevail on the parol evidence issue. Just as full enforcement of the merger clause despite its partial illegality would be contrary to the purpose of the new FTC Rule

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[356] *See* PERILLO, *supra* note 170, § 22.2 (2003) ("Even if an agreement is illegal, there are a number of situations in which a party may recover for breach of an illegal executory bilateral contract.").

[357] FARNSWORTH, *supra* note 201, § 5.5 (footnote omitted).

[358] PERILLO, *supra* note 170, § 22.1 (footnotes omitted).

[359] *Id.* § 22.2(d) ("An illegal provision does not necessarily render the entire contract unenforceable. If the illegal provision is not central to the agreement and does not involve serious moral turpitude, the illegal portion of the agreement is disregarded and the balance of the agreement is enforceable." (footnote omitted)).

[360] *See supra* text at note 350.

[361] *See supra* notes 214-24 and accompanying text.

[362] *See supra* text accompanying notes 219-20.

[363] *See supra* text accompanying notes 223-24.

[364] *Id.*

provision, a finding that the Franchise Agreement was a complete integration despite the absence of a fully enforceable merger clause would be contrary to that purpose. Prospective franchisees are entitled to rely on the contents of disclosure documents, and judges who understand that entitlement are unlikely to let the parol evidence rule stand in the way.

IV. CONCLUSION

Freedman v. Meldy's[365] and other cases in which courts have refused to imply a private action under the FTC Rule may have the virtue of judicial deference, but they can lead to injustice in cases like Brown's. Courts should add a common law action for breach of express warranty to the legal arsenal of a franchisee who suffers injury as a result of improper disclosure. Together with the new Rule provision, that action will help remedy injustice in some cases.

Section 2-313 can play an important role in persuading courts to expand express warranty law to cover franchise sales. As Barkley Clark and Christopher Smith observe, Article 2 is "by far the most important source of warranty law today."[366] Like the rest of the Article, the section is in force in every state except Louisiana and has generated well-developed bodies of interpretative case law and academic commentary. Particularly in a jurisdiction with few helpful common law precedents, the section and its case law offer a blueprint for the common law development.

Courts will probably continue to hold that sales of business format franchises lie outside the boundaries of Article 2. As the ABA Forum on Franchising panelists suggested,[367] however, franchise lawyers and courts should nevertheless consider the potential usefulness of Article 2 policies in resolving business format franchise disputes.

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[365] 587 F. Supp. 658 (E.D. Pa. 1984). For discussion of the case, see *supra* text at notes 74-82.

[366] 1 CLARK & SMITH, *supra* note 228, § 1:4, at 1-6.

[367] *See supra* text at note 5.